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# PRINCIPLES OF GOOD SUPERVISION AND THE REGULATION OF THE DUTCH DRINKING WATER SECTOR

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## **Abstract**

*In March 2014, the OECD issued a report in which it indicated that the Netherlands “has an excellent track record on water management in several areas”. The OECD mentions for example that the Netherlands has developed a “strong economy and robust water industry”, this despite that 55% of the Netherlands’ territory is below sea level. However, the OECD also concluded that Dutch water governance “relies on a system of many checks and balances ... [and] that system presents some limitations.” In response to the conclusion of the OECD, this article discusses the current framework of economic regulation of the Dutch drinking water sector. The article develops a normative framework to assess whether the current organization of economic regulation is adequate. The assessment examines to which extent the principles of good regulation are observed by economic regulation of the drinking water sector. It is concluded that the Dutch framework of economic regulation of the drinking water sector displays several weaknesses in light of the principles of good regulation. In particular, the principles of transparency and independency need better observance. As a result the protection of the interests of the users of drinking water is at stake. This article ends with some recommendations to enhance the quality of economic regulation of the Dutch drinking water sector.*

**Keywords:** Drinking water sector, economic regulation, independence, Principles of good regulation, The Netherlands, water governance

**JEL:** K 2 en K 23

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## 1. INTRODUCTION

In 2011, the OECD indicated in its report '*Water governance in OECD countries – A multi-level approach*' that "water governance<sup>1</sup> remains in a state of confusion." From a legal perspective, the most startling points mentioned to illustrate this state of confusion are, *inter alia*, the "fragmented institutional structures", the "unclear allocation of roles and responsibilities", and the "poor economic regulations and poorly drafted legislation."<sup>2</sup> For the Netherlands, the existence of these problems has been confirmed by the OECD's most recent report, '*Water Governance in the Netherlands: Fit for the Future?*' In this report, the OECD mentions the "excellent track record on water management in several areas", such as the fact that the Netherlands has developed a "strong economy and robust water industry", this despite that 55% of the Netherlands' territory is below sea level.<sup>3</sup> However, this report also concludes that water governance in the Netherlands "relies on a system of many checks and balances ... [and] that system presents some limitations."<sup>4</sup> The OECD further considers that "another striking fact of the Dutch regulatory model is the absolute lack of a third-party institution or independent mechanism for monitoring of overall performance and compliance of the drinking water companies that are in the hands of public shareholders (municipalities and provinces)."<sup>5</sup> More specifically, a report from the Inspectorate for Transport, Public Works and Water Management concluded that the Dutch drinking water companies could not provide sufficient insight in how the drinking water tariff for 2012 was established.<sup>6</sup>

These conclusions signal that the current organization of regulation of the drinking water sector might need improvement. In this light, this article examines whether the current organization of economic regulation of the Dutch drinking water sector is adequate, and if needed, how it can be improved. When this contribution refers to economic regulation it refers to the laws, implementing rules and regulatory decisions (such as tariff decisions) that regulate the economic obligations and rights of actors in the drinking water sector. The term regulation can be distinguished from the term independent regulator, which is the authority that is independent from the

<sup>1</sup> In this article, governance of the water sector is a broad concept that refers to the entire organisation of the water sector, including all stakeholders involved and their relations with the water sector, see OECD (2011), '*Water Governance in OECD Countries: A Multi-level Approach*', p. 28. The article focuses on the legal economic part of governance that is referred to as economic regulation. In this context, economic regulation of the drinking water sector is of importance. Economic regulation comprises the legal rules regarding the economic obligations of the actors in the water sector in order to meet predetermined objectives; these objectives are established in water policies.

<sup>2</sup> OECD (2011), '*Water Governance in OECD Countries: A Multi-level Approach*', p. 17.

<sup>3</sup> OECD (2014), '*Water Governance in the Netherlands: Fit for the Future?*', p. 17.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid, p. 257.

<sup>6</sup> Inspectorate, '*Toezicht Drinkwatertarieven – Beoordeling tarieven 2012*'.

market parties and to some extent from the politics when applying the laws and rules by adopting regulatory decisions.<sup>7</sup>

In order to come to useful recommendations, the paper will firstly introduce the interests which need to be safeguarded and the characteristics of the Dutch drinking water sector. Next, the applicable requirements of EU law will be referred to. Principles of good regulation are introduced to develop a normative framework. Subsequently, the current organization of economic regulation is assessed for its compliance with these principles. Following the assessment, other forms of economic regulation in the energy sector and the UK water sectors are briefly discussed to see whether lessons can be learned for the regulation of the Dutch water sector. These examples are chosen, as the implementation of the principles of good regulation in these sectors has led to recent changes and improvements of the regulatory regimes. Those changes may serve as a source of inspiration for a reflection on the implementation of the principles of good regulation in the Dutch drinking water sector. The article concludes with recommendations to improve economic regulation of the Dutch drinking water sector.

## 2. PUBLIC INTEREST SAFEGUARDED IN THE DUTCH DRINKING WATER SECTOR

The organizational set-up of the Dutch drinking water sector aims to protect several public interests. According to the Dutch Scientific Council for Government Policy, a public interest is an interest of importance to society that is liable to be insufficiently safeguarded if the government would not interfere.<sup>8</sup> A small inventory<sup>9</sup> of the public interests which should be safeguarded in the Dutch drinking water sectors shows that economic regulation needs to guarantee that drinking water has to be provided universally<sup>10</sup> whilst ensuring security of supply.<sup>11</sup> For the drinking water companies, the obligation to provide drinking water universally means that every inhabitant of the Netherlands must be able to have access to drinking water<sup>12</sup> and receive it at a (reasonable and) uniform price. If no such universal service *obligation* would exist, the provision of drinking water in unprofitable regions would be jeopardized. It

<sup>7</sup> See for a further discussion of different regulatory arrangements, OECD (2015), *The Governance of Water Regulators*, p. 16.

<sup>8</sup> WRR (2000), *Het borgen van publiek belang*, found <[www.wrr.nl/fileadmin/nl/publicaties/PDF-Rapporten/Het\\_borgen\\_van\\_publiek\\_belang.pdf](http://www.wrr.nl/fileadmin/nl/publicaties/PDF-Rapporten/Het_borgen_van_publiek_belang.pdf)>, p. 46.

<sup>9</sup> See TILEC Discussion paper 2015, forthcoming, for a more elaborate description of each public interest.

<sup>10</sup> *Kamerstukken II* 1999/2000, 27018, no. 1, p. 8.

<sup>11</sup> *Ibid*, p. 9.

<sup>12</sup> *Kamerstukken II* 2006/2007, 30895, no. 3, p. 28.

should also be guaranteed that captive users are protected<sup>13</sup> against possible consequences of the lack of competition between drinking water companies. Furthermore, environmental and public health considerations should also be taken into account in the economic regulation of the drinking water sector. If not so, there is a risk that the economic regulation conflicts with existing regulation in the area of public health and the environment.<sup>14</sup> The next paragraph elaborates how existing economic regulation in the drinking water sector aims to protect the public interests identified above.<sup>15</sup>

### 3. CHARACTERISTICS OF THE DUTCH DRINKING WATER SECTOR

In the Netherlands, ten drinking water companies provide drinking water to all users – i.e. domestic and non-domestic users. After delivery to the user, a drinking water company is no longer responsible for the supplied water, as in general, responsibility for the collection of wastewater lies with the municipalities. The regional water authorities are in charge of the wastewater treatment.<sup>16</sup>

Only drinking water companies may produce and deliver drinking water and each drinking water company has its own supply area, allocated to it by the Minister of Infrastructure and Environment (Minister of I&E).<sup>17</sup> The ownership of a drinking water company is governed by law, as a drinking water company has to be a public legal entity or it has to be directly or indirectly owned by a public legal entity.<sup>18</sup> This means that drinking water is provided by public monopolies, each ensuring the provision of drinking water in an exclusive supply area.<sup>19</sup>

The duties of a drinking water company are listed in the Drinking Water Act, which obliges each drinking water company to, *inter alia*, provide drinking water within its supply area.<sup>20</sup> The Drinking Water Act requires drinking water companies

<sup>13</sup> *Kamerstukken II* 1999/2000, 27018, no. 1, p. 9.

<sup>14</sup> *Zie verder Kamerstukken II* 2006/2007, 30895, no. 3, p. 28.

<sup>15</sup> *Kamerstukken II* 2006/2007, 30895, no. 3, p. 28.

<sup>16</sup> Article 10.33 Environmental Management Act and Article 3.4(1) Water Act in conjunction with Article 1(2) Water Authorities Act; an exception is the drinking water company Stichting Waternet, which is not only in charge of the production and distribution of drinking water, but also for the collection and treatment of wastewater, Vewin (2012), '*Drinkwaterstatistieken 2012*', Vereniging van waterbedrijven in Nederland, Rijswijk, Netherlands, p. 41.

<sup>17</sup> Articles 4(1) and 5(1) Drinking Water Act in conjunction with Article 4 Drinking Water Regulation, however, Article 4 Drinking Water Act foresees in the possibility to provide exemptions from the prohibition of producing and distributing drinking water.

<sup>18</sup> Article 15 in conjunction with Article 1(1) Drinking Water Act.

<sup>19</sup> E. Dijkgraaf, S. van der Geest and M. Varkevisser (2007), '*Winstregulering als waarborg voor redelijke tarieven*', Erasmus Competition and Regulation Institute, Rotterdam, the Netherlands, p. 5.

<sup>20</sup> Article 7(1) Drinking Water Act.

to charge a tariff for drinking water that is cost-effective, transparent and non-discriminatory.<sup>21</sup> The costs which are made in the exercise of the main tasks may be passed on to users of drinking water,<sup>22</sup> as well as the cost of capital – whereby the weighted average cost of capital (WACC) and the maximum percentage of equity is demarcated by the Minister of I&E.<sup>23</sup> Drinking water companies have to show how their costs are incorporated in the drinking water tariff in their budgets.<sup>24</sup>

The Inspectorate for Transport, Public Works and Water Management (Inspectorate) monitors compliance with the Drinking Water Act.<sup>25</sup> The Inspectorate is part of the Ministry of Infrastructure and Environment. For monitoring compliance with the financial obligations imposed by law, two aspects of the Drinking Water Act are of importance: financial oversight<sup>26</sup> and the performance comparison (benchmark).<sup>27</sup>

Financial oversight takes place annually when the Minister of I&E receives a report from each drinking water company which gives insight into the costs and operating profits of the previous calendar year.<sup>28</sup> In case the profits earned exceed the predetermined WACC, drinking water companies are required to incorporate a compensation for this in the following year's tariff.<sup>29</sup> If Article 11 or 12 of the Drinking Water Act, which provide for the financial specifications of the tariff and financial oversight, are not complied with, the Minister of I&E is authorized to give an instruction to the owner of the drinking water company concerned.<sup>30</sup> A deadline is fixed before which the instruction has to be complied with and the binding nature of the instruction is underlined by Article 50 of the Drinking Water Act which indicates that administrative enforcement may be exerted by the Minister of I&E.<sup>31</sup>

The performance comparison is a triennially recurring systematic comparison which compares the ten drinking water companies on quality, customer service, environmental aspects and cost efficiency.<sup>32</sup> While this benchmark used to be voluntary, the Drinking Water Act made it compulsory for all drinking water

<sup>21</sup> Article 11(1) Drinking Water Act.

<sup>22</sup> Article 8(1) Drinking Water Decision.

<sup>23</sup> Articles 10(2 and 3) and 11(2) Drinking Water Act.

<sup>24</sup> Article 12(1) Drinking Water Act.

<sup>25</sup> Article 48(1) Drinking Water Act in conjunction with Besluit aanwijzing ambtenaren VROM-regelgeving and Organisatie- en mandaatbesluit Inspectie Leefomgeving en Transport 2012.

<sup>26</sup> Article 12(2) Drinking Water Act.

<sup>27</sup> Article 39 Drinking Water Act.

<sup>28</sup> Article 12(2) Drinking Water Act.

<sup>29</sup> Article 12(3) Drinking Water Act.

<sup>30</sup> Article 13(2) Drinking Water Act.

<sup>31</sup> *Kamerstukken II* 2006/2007, 30895, no. 3, p. 32.

<sup>32</sup> Article 39 Drinking Water Act in conjunction with Article 57 Drinking Water Decision and Article 17 Drinking Water Regulation.

companies,<sup>33</sup> with the Inspectorate in charge.<sup>34</sup> The first mandatory benchmark has been delivered in 2012. According to the ‘*Protocol Performance Comparison Drinking Water Companies 2012*’ of the Inspectorate, Vewin, who was previously in charge of the voluntary benchmark,<sup>35</sup> is responsible for the data collection.<sup>36</sup> Vewin is the Association of Dutch Water Companies of which all ten drinking water companies are member. The Minister of I&E and the drinking water companies receive a copy of the performance comparison from the Inspectorate.<sup>37</sup> On the basis of this benchmark, drinking water companies have to indicate which improvements they will make. The Minister of I&E informs both Houses of the States General of the intentions of the drinking water companies.<sup>38</sup>

Additionally, this benchmarking ought to play a role in the decentralized financial supervision of the drinking water sector. Decentralized supervision of the drinking water sector refers to the fact that in the Netherlands, the shareholders of the drinking water companies are municipalities and provinces. The supervision they exercise as shareholders, covers the common financial monitoring that a shareholder exercises on his business. The shareholders of the drinking water companies, which have an important role since they are also responsible for approving the drinking water tariff,<sup>39</sup> are expected to use the results for supervising purposes.<sup>40</sup> Using the benchmark however, is not obligatory for the shareholders. The circumstance that it is up to the shareholders to decide how – and whether – to use the results of the benchmark confirms the soft character of this part of decentralized financial supervision of the drinking water companies.

The leeway for the shareholders in exercising decentralized supervision is strengthened by the fact that not more than an advisory role is reserved for the Authority for Consumers and Markets (ACM). This is the regulatory authority of the Dutch economy, charged with the supervision and regulation of network sectors, the enforcement of competition law and consumer law. The Drinking Water Regulation stipulates that the Minister of I&E has to ask advice from the ACM when

<sup>33</sup> Vewin (2013), ‘*Water in Zicht 2012 – Bedrijfsvergelijking drinkwatersector*’, Vereniging van waterbedrijven in Nederland, Rijswijk, Netherlands, p. 5.

<sup>34</sup> Article 18 Drinking Water Regulation.

<sup>35</sup> See for more on voluntary benchmarking before the coming into force of the Drinking Water Act, M. Blokland, M. Schouten and K. Schwartz, ‘Rejuvenating a Veteran Benchmarking Scheme: Benchmarking in the Dutch Drinking Water Sector’, *Competition and Regulation in Network Industries*, 2010–2, pp. 138–139.

L. Hancher, P. Larouche and S. Lavrijssen (2004), ‘Principles of Good Market Governance’, *Tijdschrift voor Economie en Management*, vol. XLIX issue 2, 2004, p. 344;.

<sup>36</sup> Inspectorate, ‘*Protocol Prestatievergelijking Drinkwaterbedrijven 2012*’, p. 6.

<sup>37</sup> Article 43(2) Drinking Water Act.

<sup>38</sup> Article 44 Drinking Water Act.

<sup>39</sup> Article 20 Drinking Water Act.

<sup>40</sup> Vewin (2013), ‘*Water in Zicht 2012 – Bedrijfsvergelijking drinkwatersector*’, Vereniging van waterbedrijven in Nederland, Rijswijk, Netherlands, p. 15.

it sets the WACC and the maximum percentage of equity.<sup>41</sup> The Drinking Water Regulation obliges the Inspectorate to ask advice from the ACM for the financial oversight and the monitoring whether the provisions of the drinking water regulation dealing with the drinking water tariffs are complied with.<sup>42</sup> It deserves to be mentioned that the advice of the ACM has been consistently taken over by the Minister of I&E in the determination of both the WACC and the maximum percentage of equity.<sup>43</sup> In case the Minister of I&E would intend to deviate from the advice of the ACM, the General Administrative Law Act obliges the Minister of I&E to properly motivate its intention.<sup>44</sup> While there is no explicit legal obligation to do so,<sup>45</sup> the ACM gives stakeholders the chance to give their opinion upon the draft-advice of the ACM.

It follows from the above that economic regulation is a shared responsibility between the Minister of I&E, the Inspectorate and the drinking water companies. If anything should go wrong, the drawback of the current situation is that it is difficult to indicate who exactly is responsible. For instance, in case the tariff of drinking water is clearly excessive, it is difficult to point out who should be held accountable. Reason for this is that while the tariff is set by a decision from the shareholders of the drinking water company, the problem might not be an erroneous decision of the shareholders, but for example an overly excessive WACC rate set by the Minister of I&E on the basis of advice from the ACM. Or, the high tariff may lie in an unnecessary increase in the production costs on the part of the drinking water companies, or a high maximum percentage of equity – also determined by the Minister of I&E on the basis of advice from the ACM. As for every aspect of the drinking water tariff a different player is involved, the question of who is ultimately responsible for the drinking water tariff cannot easily be answered.

<sup>41</sup> Article 8a Drinking Water Decision in conjunction with Article 7 Drinking Water Regulation. The Ministry of I&E sets the WACC based on benchmarks elaborated by UK consultancies, taking the UK and US water industry as a reference, see <[www.tweedekamer.nl/kamerstukken/brieven\\_regering/detail?id=2013Z20542&did=2013D42404](http://www.tweedekamer.nl/kamerstukken/brieven_regering/detail?id=2013Z20542&did=2013D42404)>.

<sup>42</sup> Article 7(2) Drinking Water Regulation.

<sup>43</sup> Besluit van de Staatssecretaris van Infrastructuur en Milieu van 24 oktober 2011, nr. DP2011055738, ter vaststelling van het maximaal toegestane aandeel eigen vermogen, bedoeld in artikel 10, tweede lid, van de Drinkwaterwet, voor 2012 en 2013; Besluit van de Staatssecretaris van Infrastructuur en Milieu van 24 oktober 2011, nr. DP2011055738, ter vaststelling van de gewogen gemiddelde vermogenskostenvoet, bedoeld in artikel 10, derde lid, van de Drinkwaterwet, voor 2012 en 2013; and Besluit van de Minister van Infrastructuur en Milieu, van 28 oktober 2013, nr. IENM/BSK-2013/239467, ter vaststelling van de gewogen gemiddelde vermogenskostenvoet, bedoeld in artikel 10, derde lid, van de Drinkwaterwet, voor 2014 en 2015.

<sup>44</sup> Article 3:50 General Administrative Law Act.

<sup>45</sup> However, it can be stated that the ACM gives effect to its duty to prepare its advices carefully by giving stakeholders the chance to submit views.



## 4. REQUIREMENTS IMPOSED BY PRIMARY EU LAW ON THE ORGANISATION OF ECONOMIC REGULATION OF THE DRINKING WATER SECTOR

### 4.1. THE PROVISION OF DRINKING WATER: WHAT KIND OF SERVICE OF GENERAL INTEREST?

Considering that safe drinking water is a necessity of life, little has to be done to demonstrate that the provision of drinking water is a service of general interest.<sup>46</sup> However, the question whether the provision of drinking water is a service of general *economic* interest needs more consideration.

In this regard, the classification of services in EU law as services of general interest (SGI) matters. These SGIs are divided into services of general economic interest (SGEI) and services of general non-economic interest (SGNEI).<sup>47</sup> If the provision of drinking water would be classified as a SGEI, a wider set of EU rules applies than if the classification would be as a SGNEI: most notably EU competition laws come into sight at the classification as SGEI since the drinking water companies are then ‘undertakings’ within the meaning of EU competition law.<sup>48</sup>

#### 4.1.1. Guidelines stemming from the ECJ

Case law of the European Court of Justice (ECJ) indicates that whether an activity is of an economic nature, should be decided on the basis of a functional approach. Consequently, no clearly defined criteria are used to define economic activity. Nevertheless, guidance can be found in case law. For example in *Ambulanz Glöckner*, the ECJ stated that “any activity consisting in offering goods and services on a given market is an economic activity.”<sup>49</sup> In *Compass-Datenbank*, the ECJ stated that “activities which fall within the exercise of public powers are not of an economic nature.”<sup>50</sup> Until now, not many activities have been found to fall within this exception, as it applies only to classic state activities, such as the army or the police.<sup>51</sup>

<sup>46</sup> See for example P. Bauby (2012), ‘Local services of general economic interest in Europe – Water services: what are the Challenges?’, *Annals of Public and Cooperative Economics*, vol. 83 issue 4, 2012, p. 563.

<sup>47</sup> A. Jones and B. Sufrin (2014), *EU Competition Law: Text, Cases and Materials*, Oxford: Oxford University Press, 2010, p. 597.

<sup>48</sup> See Article 106(2) TFEU which mentions that competition law applies to SGEIs in so far as the application of such rules does not obstruct the performance of the SGEI; and European Commission (2003), Green Paper on Services of General Interest, COM(2003) 270 final, point 43.

<sup>49</sup> ECJ 25 October 2001, *Ambulanz Glöckner*, C-475/99, ECLI:EU:C:2001:577, par. 19.

<sup>50</sup> ECJ 12 July 2012, *Compass-Datenbank*, C-138/11, ECLI:EU:C:2012:449, par. 36.

<sup>51</sup> European Commission, Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, 2012/C 8/02, point 16.

Next to the exercise of public powers, the solidarity exception is also approved by the ECJ to rule out the application of the EU competition rules. This exception applies when an activity fulfils an exclusively social function.<sup>52</sup> It is apparent from the wording and application practice of the solidarity exception that this exception is tailored for social security and health schemes.<sup>53</sup>

The ECJ, by repeatedly omitting to mention the possibility of classifying an activity as a SGNEI, starts from the preposition that the choice is between either qualifying an activity as a normal economic activity or as a SGEI.<sup>54</sup> It is therefore not so much the ‘economic nature’ upon which the Member States have a broad discretion. Instead, the wide margin of discretion appears to apply to whether a certain activity is of general interest or not – subject to control against manifest errors.<sup>55</sup> In *BUPA*, the ECJ confirms this reading by stating that a Member State cannot exercise its powers to define SGEIs “for the sole purpose of removing a particular sector ... from the application of the competition rules.”<sup>56</sup>

On the basis of the functional approach of the ECJ, the Commission, the ACM and several other Member States – like the United Kingdom and France – have taken the stance that the provision of drinking water is an economic activity.<sup>57</sup>

#### 4.1.2. From functional case law to a formalistic view

In contrast to the functional approach of the ECJ, the Dutch government takes a formalistic view and considers the provision of drinking water a SGNEI.<sup>58</sup>

In a reply specifying the choice for the classification of the provision of drinking water as a SGNEI, the then Minister of Housing, Spatial Planning and Environment (Minister of H, SP&E)<sup>59</sup> put forward that it is up to the Member States to decide whether they classify a SGI as economic or not. According to this reply, whether an activity is of an economic nature depends upon the extent to which the entity performing the

<sup>52</sup> ECJ 17 February 1993, *Poucet and Pistre v AGF and Cancava*, C-159/91 and C-160/91, ECLI:EU:C:1993:63, par. 18–19.

<sup>53</sup> See for example ECJ 3 March 2011, *AG2R Prévoyance*, C-437/09, ECLI:EU:C:2011:112; ECJ 5 March 2009, *Kattner Stahlbau*, C-350/07, ECLI:EU:C:2009:127; and ECJ 11 July 2006, *FENIN v Commission*, C-205/03 P, ECLI:EU:C:2006:453.

<sup>54</sup> EGC 15 June 2005, *Olsen v Commission*, T-17/02, ECR, ECLI:EU:T:2005:218, par. 216.

<sup>55</sup> EGC 12 February 2008, *BUPA and Others v Commission*, T-289/03, ECLI:EU:T:2008:29, par. 166.

<sup>56</sup> *Ibid*, par. 168.

<sup>57</sup> See for example European Commission (1990), XX<sup>th</sup> Report on Competition Policy, p. 12; ACM (1999), Decision 1212 in *NUON Water – Waterleiding Friesland*; P. Bauby (2012), ‘Local services of general economic interest in Europe – Water services: what are the Challenges?’, *Annals of Public and Cooperative Economics*, vol. 83 issue 4, 2012, p. 565; and see Department for Environment, Food and Rural Affairs (2011), ‘*Review of Ofwat and consumer representation in the water sector*’, p. 8. See TILEC Discussion Paper 2015, forthcoming, for a more elaborate discussion of the stance of the Commission and other Member States.

<sup>58</sup> *Kamerstukken II* 2006/2007, 30895, no. 3, p. 22.

<sup>59</sup> The predecessor of the Minister of I&E.

public task is free to determine the services to be provided, the tariffs and the manner in which the services are provided. The Minister of H, SP&E noted that a limited freedom in this regard points towards the existence of a SGNEI.<sup>60</sup>

Thus, the Dutch government advocates a very formalistic view, focusing on the actual organization of the drinking water sector. It does not look at the nature of the activities and the scope for competition, for instance by considering the organization of the drinking water sector in other countries

#### 4.1.3. Summary

In spite of the opinion of the Dutch government, case law of the ECJ, the approach of the Commission and practice from other Member States provide strong arguments that the provision of drinking water is a SGEI. Accordingly, the provision of drinking water has to be regarded as an economic activity. This has as consequence that the drinking water companies are undertakings within the meaning of EU competition law. Considering that the mandatory character of the public monopolies makes it impossible for foreign companies to enter the Dutch drinking water sector, cross-border trade is impeded. As a result, EU (competition) law applies to the provision of drinking water in the Netherlands. The following sub-paragraphs will investigate how the economic nature of the provision of drinking water affects the requirements that are applicable to the organization of the economic regulation of the drinking water sector.

### 4.2. REQUIREMENTS FLOWING FROM PRIMARY EU LAW

The first indication of the requirements flowing from EU law, comes from Article 106 TFEU. Its first paragraph encompasses a prohibition addressed to Member States having public undertakings and undertakings with special or exclusive rights. These Member States are not allowed to enact or maintain in force “any measure contrary to the rules contained in the Treaties, in particular those provided for in Article 18 and Articles 101 to 109 [TFEU].” The prohibition of Article 106(1) TFEU demonstrates that both EU competition law and internal market law influence the organization of economic regulation of the Dutch drinking water sector.<sup>61</sup>

<sup>60</sup> *Kamerstukken I* 2008/2009, 30895, no. D, p. 4.

<sup>61</sup> It should be noted that Article 106(2) TFEU plays a role as well. Whether and when this Article could be relied upon by Member States to justify an infringement of the Treaty rules (both EU competition and internal market law) is still a topic under debate. In ECJ 1 July 2008, *MOTOE*, C-49/07, ECLI:EU:C:2008:376, par. 46, reasoning of the ECJ shows that only undertakings – and not Member States – can rely upon Article 106(2) TFEU. In contrast, it is established case law that Member States may invoke Article 106(2) TFEU when they are suspected of breach of Article 106(1) in conjunction with Article 102 TFEU, see in this regard T. Bekkedal, ‘Article 106 TFEU is Dead. Long Live Article 106 TFEU!’ in: E. Szyszczak and others (eds.), *‘Developments in Services of General Interest’*, Den Haag: T.M.C. Asser Press, 2011, p. 67.

In light of EU law, Article 102 TFEU provides the most stringent rules for the organization of the Dutch drinking water sector. Considering that drinking water companies have a dominant position – they are monopolist in their supply area – economic regulation needs to ensure that the drinking water companies are not led to infringe Article 102 TFEU. Should economic regulation fail to do so, the Netherlands risks infringement of Article 106(1) in conjunction with Article 102 TFEU.<sup>62</sup> Reading of Article 106(1) TFEU and the principle of sincere cooperation enshrined in Article 4(3) TEU signifies that the four freedoms related to the attainment and maintenance of the internal market may not be obstructed by Member States. And indeed, even though the EU acknowledges the existence of SGEIs and state monopolies, the basic rules on free movement still apply to these areas.<sup>63</sup>

For reasons of clarity, it should be stressed that this article does not seek to challenge the organization of the Dutch drinking water sector as a public monopoly. Instead, it seeks to find the applicable requirements to which the economic regulation of the drinking water sector has to comply. That the Dutch drinking water sector is in hands of public undertakings is not necessarily problematic. Under EU law, ownership is of no influence to the applicable rules while public and private providers of services of general (economic) interest “are subject to the same rights and obligations.”<sup>64</sup> However, public monopolies may conflict with the free movement rules. Whether and how the free movement rules are infringed by the existence of public monopolies, falls outside the scope of this article.<sup>65</sup> This article focusses on the institutional design of the Dutch drinking water sector and its compliance with the principles of good regulation to make sure there are adequate safeguards to prevent that economic regulation leads to infringement of Articles 106, lid 1 and 102 TFEU.

#### 4.3. WATER FRAMEWORK DIRECTIVE

Secondary EU law also gives guidance to economic regulation of the drinking water sector. In this regard, the EU Water Framework Directive<sup>66</sup> needs to be mentioned. In

<sup>62</sup> See ECJ 23 April 1991, *Höfner and Elser v Macrotron*, C-41/90, ECLI:EU:C:1991:161, par. 28–29; and ECJ 18 June 1991, *ERT v DEP*, C-260/89, ECLI:EU:C:1991:254, par. 37.

<sup>63</sup> See A. Rosas and L. Armati (2012), *‘EU constitutional law – an introduction’*, Oxford: Hart Publishing, 2012, p. 203.

<sup>64</sup> European Commission (2003), Green Paper on Services of General Interest, COM(2003) 270 final, point 21.

<sup>65</sup> Infringements of the free movement rules however, may be justified by justification grounds which can be relied upon by the Netherlands. For a more elaborate account on the requirements stemming from EU law, see TILEC Discussion paper 2015 no 2, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2552036](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2552036).

<sup>66</sup> Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for the Community action in the field of water policy (OJ 2000, L327/1).

the exercise of its duties – for example in tariff setting – the regulatory authority should take account of the Water Framework Directive.

Article 9 of the Water Framework Directive indicates that the principle of recovery of costs and the polluter pays principle are to be recognized in the price for water services.<sup>67</sup> Additionally, this Article also indicates that water-pricing policies should provide incentives to use water resources efficiently. According to the Commission, this is essential as a sustainable use of water resources is stimulated when users of water services are confronted with the real costs of their water usage.<sup>68</sup>

A recent judgment of the ECJ confirmed the importance of the principle of cost-recovery and the polluter pays principle.<sup>69</sup> However, in its judgment, the ECJ also indicated that the Water Framework Directive is not necessarily infringed if a particular water service is not subject to the principle of cost-recovery.<sup>70</sup> Key is that the objective of the Water Framework Directive, i.e. protection of the environment, is not jeopardized – but the principle of recovery of costs and the polluter pays principle are valuable instruments to achieve protection of the environment.<sup>71</sup>

Considering that the Framework Directive indicates that water-pricing policies should provide “adequate incentives for users to use water resources efficiently,”<sup>72</sup> it should be noted that this is not entirely reflected in the Drinking Water Act.<sup>73</sup> Drinking water companies are not subject to any obligation to incentivize users of drinking water to an efficient water use. Whether the polluter-pays principle is sufficiently obeyed is also questionable, as pollution costs are spread over all users rather than that every polluter is charged for his actual share.<sup>74</sup> The exact amount of pollution per domestic user – which is, admittedly, difficult to assess – is therefore not taken into account.

<sup>67</sup> See also W. Howarth (2009), ‘Cost Recovery for Water Services and the Polluter Pays Principle’, *ERA Forum*, 10 (4), pp. 565–587; and J. Cuijpers (2008), ‘The polluter-pays! But for what?’, Official Publication of the *European Water Association*.

<sup>68</sup> See <[http://ec.europa.eu/environment/water/water-framework/info/intro\\_en.htm](http://ec.europa.eu/environment/water/water-framework/info/intro_en.htm)>; it should be kept in mind, however, that it is rather difficult to calculate real costs of water usage per citizen, as these costs are bound to vary per person and per region.

<sup>69</sup> ECJ 11 September 2014, *Commission v Germany*, C-525/12, ECLI:EU:C:2014:2202, par. 44.

<sup>70</sup> *Ibid*, par. 58.

<sup>71</sup> *Ibid*, par. 54–55.

<sup>72</sup> Article 9(1) Water Framework Directive 2000/60/EC.

<sup>73</sup> However, this need not be in breach of the Water Framework Directive. According to Article 9(4) Water Framework Directive 2000/60/EC, Member States are not in breach of the Water Framework Directive in case they do not apply the provisions of the first paragraph, second sentence of Article 9, as long as the non-application does not compromise the purposes and the achievement of the objectives of the Water Framework Directive.

<sup>74</sup> See <[www.hefpunt.nl/waterschapsbelastingen/zuiveringsheffing.html](http://www.hefpunt.nl/waterschapsbelastingen/zuiveringsheffing.html)>.

## 5. PRINCIPLES OF GOOD REGULATION

Next to EU law, principles of good regulation are equally relevant for organizing economic regulation of the drinking water sector.<sup>75</sup> These norms are important for the organization of economic regulation of the drinking water sector, as they form a basis for legislation and regulation in the network industries in EU Member states and beyond.<sup>76</sup> This basis consists of norms which, although differently colored according to the situation in which they are used by different authorities employing them, provide a core of “normative, universal values”<sup>77</sup> which are generally reflected in legislation and practice as norms that are guaranteed.

These norms do not necessarily flow from legal provisions, but from different sources such as the OECD, scientific literature, international organizations and national governments. In the EU, they are generally referred to as general principles of EU law since also the ECJ recognizes them in its case law.<sup>78</sup> It should be noted that as of 4 June 2015, also principles of good regulation from the OECD are effective. The OECD has identified twelve principles relating to the effectiveness, efficiency, trust and engagement of water governance.<sup>79</sup> Part of these principles corresponds to principles used in this article for the assessment of economic regulation of the Dutch drinking water sector. The OECD for example, also recognizes that transparency and participation are crucial for a well-functioning (drinking) water sector. The OECD has indicated that it expects that these principles will lead to “concrete changes from governments and stakeholders.”<sup>80</sup>

Despite their differences in legal status, it is well-established that principles of good regulation play a role in the assessment of economic regulation.<sup>81</sup> The implementation of the principles of good regulation provides safeguards to protect the water users against the drinking water companies abusing their dominant position. In the context of economic regulation of the drinking water sector, the role of the EU principles of good regulation can be understood as the provision of a

<sup>75</sup> See in this regard, M. Aelen (2014), *Beginnelsen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, 2014.

<sup>76</sup> L. Hancher, P. Larouche and S. Lavrijssen (2004), ‘Principles of Good Market Governance’, *Tijdschrift voor Economie en Management*, vol. XLIX issue 2, 2004, p. 344.

<sup>77</sup> S. Lavrijssen (2006), *Onafhankelijke mededingingstoezichthouders, regulerende bevoegdheden en de waarborgen voor good governance*, Den Haag: Boom Juridische uitgevers, 2006, p. 41.

<sup>78</sup> H. Addink (2005), ‘Principles of Good Governance: Lessons from Administrative Law’, in: D. Curtin and R. Wessel (eds.), *Good Governance and the European Union – Reflections on Concepts, Institutions and Substance*, Antwerp – Oxford – New York: Intersentia, 2005, p. 34.

<sup>79</sup> See <[www.oecd.org/gov/regional-policy/OECD-Principles-on-Water-Governance-brochure.pdf](http://www.oecd.org/gov/regional-policy/OECD-Principles-on-Water-Governance-brochure.pdf)>.

<sup>80</sup> See <[www.oecd.org/governance/oecd-principles-on-water-governance-from-vision-to-action.htm](http://www.oecd.org/governance/oecd-principles-on-water-governance-from-vision-to-action.htm)>.

<sup>81</sup> They are used by the OECD, the European Commission, Member States and national regulatory authorities. See for example OECD (2014), ‘*The Governance of Regulators*’; and European Commission (2001), *European governance – a white paper*, COM(2001) 428 final.

normative framework within which assessment of European and national legislation, administration, regulation and enforcement can take place.<sup>82</sup>

### 5.1. INDEPENDENCE

In early case law the ECJ stated that the national regulatory authority that is in charge of the application of economic regulation needs to be independent from market parties.<sup>83</sup> Independence of the implementation of the law can partially be guaranteed by the law itself by providing the conditions and restrictions for its application by the responsible regulatory authority. However the law cannot regulate every economic aspect of the drinking water sector. Therefore the law needs to be sufficiently flexible to be adapted to changing economic, environmental and social circumstances. This can be ensured by attributing the regulatory authority a sufficient degree of discretion for the application of the applicable regulatory framework.<sup>84</sup>

Independence of the market parties is in particular essential to ensure that stakeholders with a dominant position cannot influence the content of economic regulation.<sup>85</sup> According to the ECJ, the requirement of independence of the regulatory authority, flowing from Articles 106 and 102 TFEU, guarantees the “equality of opportunity”<sup>86</sup> between economic operators. In its case law, the ECJ suggests that more is needed than merely independence from market parties with a dominant position. Independence from all market parties – public and private – is required.<sup>87</sup> In light of Article 4(3) TEU which contains the principle of sincere cooperation, the application of the principle of independence from market parties implies that independence from all market parties needs to be achieved to ensure an effective application of EU

<sup>82</sup> S. Lavrijssen (2006), *Onafhankelijke mededingingstoezichhouders, regulerende bevoegdheden en de waarborgen voor good governance*, Den Haag: Boom Juridische uitgevers, 2006, p. 51; S. Prechal and M. de Leeuw, ‘Transparency: A General Principle of EU Law?’, in: U. Bernitz, J. Nergeliu and C. Cardner (eds.), *General Principles of EC Law in a Process of Development*, Alphen aan den Rijn: Kluwer Law International, 2008, p. 203; and H. Addink (2005), ‘Principles of Good Governance: Lessons from Administrative Law’, in: D. Curtin and R. Wessel (eds.), *Good Governance and the European Union – Reflections on Concepts, Institutions and Substance*, Antwerp – Oxford – New York: Intersentia, 2005, p. 30.

<sup>83</sup> ECJ 27 October 1993, *Decoster*, C-69/91, ECLI:EU:C:1993:853, par. 17, 19 and 22; reference is made to ECJ 13 December 1991, *RTT v GB-Inno-BM*, C-18/88, ECLI:EU:C:1991:474, par. 14; and to ECJ 19 March 1991, *France v Commission*, C-202/88, ECLI:EU:C:1991:120, par. 51; see in this regard also S. Lavrijssen and A. Ottow, ‘The Legality of Independent Regulatory Authorities’, in: L. Besselink, F. Pennings and A. Prechal (eds.), *The Eclipse of Legality*, Alphen aan den Rijn, Kluwer Law International, 2011, pp. 81–82.

<sup>84</sup> L. Hancher, P. Larouche and S. Lavrijssen (2004), ‘Principles of Good Market Governance’, *Tijdschrift voor Economie en Management*, vol. XLIX issue 2, 2004, p. 344.

<sup>85</sup> L. Hancher, P. Larouche and S. Lavrijssen (2004), ‘Principles of Good Market Governance’, *Tijdschrift voor Economie en Management*, vol. XLIX issue 2, 2004, p. 344.

<sup>86</sup> ECJ 27 October 1993, *Decoster*, C-69/91, ECLI:EU:C:1993:853, par. 19.

<sup>87</sup> *Ibid*, par. 19.



(competition) law.<sup>88</sup> Thus, in order to guarantee fair competition, the principle entails that the regulatory authority should be independent from all market parties.<sup>89</sup>

The second aspect of independence – political independence – is not (yet) as firmly established.<sup>90</sup> It remains controversial to demand from Member States to separate their regulatory authorities entirely or partly from political influence.<sup>91</sup> A recent OECD report on the governance of regulators, recognizes this.<sup>92</sup> The stance of the OECD elucidates that choices that are predominantly of a political nature should be left to a Ministry. Applied to the drinking water sector, such political policy choices which should be in hands of the government include the decision on what is affordable drinking water and on the quality that drinking water should (at least) have. A politically independent regulator, is in charge of guaranteeing that this desired qualitatively good drinking water is available at an affordable price. In order to do so, the independent regulatory authority takes independently (day-to-day) regulatory decisions and uses different instruments by which it autonomously tries to achieve these policy objectives.<sup>93</sup> These decisions, for example the determination of the WACC, the maximum percentage of equity and of the tariffs, should be taken without political interference.<sup>94</sup>

In order to create stability in regulatory decision-making,<sup>95</sup> to address conflicts of interest and to develop regulatory expertise, political independence is also encouraged by the OECD.<sup>96</sup> Not too long ago, also the Commission has interfered in the political autonomy of the Member States, by imposing independence requirements for the regulation of the energy and electronic communications sector. This can be seen in

<sup>88</sup> See in this regard also S. Lavrijssen and A. Ottow, 'The Legality of Independent Regulatory Authorities', in: L. Besselink, F. Pennings and A. Prechal (eds.), *The Eclipse of Legality*, Alphen aan den Rijn, Kluwer Law International, 2011, pp. 81–82; and see M. de Visser, *Network-based governance in EC law: the example of EC competition and EC communications law*, Oxford: Hart Publishing, 2009, p. 85, who states that "it is reasonable to infer that national competition authorities must be absolutely independent from commercial actors"; thereby also referring to every actor and not only to actors with a dominant position.

<sup>89</sup> See also P. Larouche (2014), 'CERRE, Code of Conduct and Best Practices for the setup, operations and procedure of regulatory authorities', p. 12.

<sup>90</sup> L. Hancher, P. Larouche and S. Lavrijssen (2004), 'Principles of Good Market Governance', *Tijdschrift voor Economie en Management*, vol. XLIX issue 2, 2004, p. 344.

<sup>91</sup> See in this regard S. Lavrijssen and A. Ottow, 'The Legality of Independent Regulatory Authorities', in: L. Besselink, F. Pennings and A. Prechal (eds.), *The Eclipse of Legality*, Alphen aan den Rijn, Kluwer Law International, 2011, pp. 79–80 and 82.

<sup>92</sup> OECD (2014), 'The Governance of Regulators', pp. 52–53.

<sup>93</sup> C. Hanretty, P. Larouche and A. Reindl (2012), 'Independence, accountability and perceived quality of regulators – a CERRE study', p. 26.

<sup>94</sup> Ibid.

<sup>95</sup> In its report, the OECD refers to regulatory decisions in general. In the drinking water sector however, these regulatory decisions would be for example the determination of the WACC and the tariff for drinking water. In light of the principle of independence, these competences should be competences of an independent regulatory authority, not of a Minister or a drinking water company.

<sup>96</sup> OECD (2014), 'The Governance of Regulators', pp. 50–51.



Article 3(3a) of Directive 2009/140/EC on electronic communications which stipulates that national regulatory authorities do not “seek or take instructions from any other body” in relation to the (by EU law designated) task they carry out. This shows that the awareness of the importance of political independence is growing.<sup>97</sup> In the Netherlands, the ACM is in charge of regulating these sectors.<sup>98</sup>

## 5.2. ACCOUNTABILITY

While independence is indispensable to guarantee objective and consistent decision-making, there is a danger that this independence will lead to a regulator acting beyond its mandate.<sup>99</sup> In order to ‘curb’ this risk, a well-functioning mechanism of accountability is required.

Bovens defines accountability as “a relationship between an actor and a forum, in which the actor has an obligation to explain and to justify his or her conduct, the forum can pose questions and pass judgment, and the actor may face consequences.”<sup>100</sup>

This practical definition focuses on the process of giving account. In the organization of economic regulation of the drinking water sector, accountability should in the first place be directed towards public authorities.<sup>101</sup> This is referred to as political accountability and it entails that the economic regulator renders account to a representative body.<sup>102</sup> This representative body, in the Netherlands this would be the Minister of I&E who is accountable to Parliament, verifies whether the regulatory authority has complied with its duties. For example, the ACM as regulatory authority of, *inter alia*, the telecommunications and transport sectors is accountable to the Minister of Economic Affairs and the Minister of I&E.<sup>103</sup>

In case an independent regulator of the drinking water sector would exist that renders account to the Minister of I&E and to the Minister of Economic Affairs, they could check, on the basis of information given to them in the process of rendering account, whether the independent regulator fulfils its duties. Political accountability expresses a possibility of democratic control, as in the end, the citizens give feedback

<sup>97</sup> See also S. Lavrijssen and A. Ottow, ‘The Legality of Independent Regulatory Authorities’, in: L. Besselink, F. Pennings and A. Prechal (eds.), *The Eclipse of Legality*, Alphen aan den Rijn, Kluwer Law International, 2011, pp. 82–83.

<sup>98</sup> Article 1.3. Telecommunications Act, Article 5 Electricity Act 1998 and Article 1a Gas Act.

<sup>99</sup> S. Lavrijssen and A. Ottow (2012), ‘Independent Supervisory Authorities: A Fragile Concept’, *Legal Issues of Economic Integration*, vol. 39 number 4, p. 421.

<sup>100</sup> M. Bovens (2006), ‘Analysing and assessing public accountability. A conceptual framework’, *European Law Journal* 2006, 13(4), p. 450.

<sup>101</sup> P. Larouche (2014), ‘CERRE, Code of Conduct and Best Practices for the setup, operations and procedure of regulatory authorities’, p. 7.

<sup>102</sup> M. Aelen (2014), *Beginselen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, 2014, p. 367.

<sup>103</sup> Article 3 Framework Act concerning Independent Administrative Bodies in conjunction with Article 6(2) Act enacting the Authority for Consumers and Markets.

on the results of the pursued policies.<sup>104</sup> This is desirable as it allows the Minister, the Parliament and at the end of the accountability chain the electorate,<sup>105</sup> to establish whether public interests are duly protected by the regulatory authority. This guarantees the proper functioning of an independent regulator and strengthens its independence.<sup>106</sup>

Secondly, the regulatory authority also needs to give account to the stakeholders, including the users of drinking water, in a more direct way. This is referred to as social accountability.<sup>107</sup> Social accountability is likely to increase support for the activities of the regulatory authority. In that regard, stakeholders might discover incidents in which their interests have insufficiently been taken into account by the regulator, or the regulator has followed the wrong procedure according to a stakeholder.<sup>108</sup> As a consequence, social accountability gives stakeholders the chance to refer such matters to the judiciary if they have legal standing.<sup>109</sup>

### 5.3. TRANSPARENCY

The principle of transparency flows from the principle of democracy,<sup>110</sup> whereby it pursues two different aims in the context of economic regulation. Firstly, it provides for legitimacy of the regulatory authority's independence<sup>111</sup> and secondly, the principle of transparency contributes to the effectiveness<sup>112</sup> of economic regulation.

<sup>104</sup> Ibid, p. 360.

<sup>105</sup> M. Bovens (2006), 'Analysing and assessing public accountability. A conceptual framework', *European Law Journal* 2006, 13(4), p. 447–468.

<sup>106</sup> It should be noted that also in the absence of an independent regulator, accountability of the regulator is equally important; see for the relationship between independence and accountability P. Larouche (2014), 'CERRE, Code of Conduct and Best Practices for the setup, operations and procedure of regulatory authorities', pp. 14–15.

<sup>107</sup> Ibid, pp. 17–18.

<sup>108</sup> S. Lavrijssen (2006), *Onafhankelijke mededingingstoezichthouders, regulerende bevoegdheden en de waarborgen voor good governance*, Den Haag: Boom Juridische uitgevers, 2006, pp. 61–62.

<sup>109</sup> Ibid, p. 62.

<sup>110</sup> M. Aelen (2014), *Beginnelsen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, p. 333; S. Prechal and M. de Leeuw, 'Transparency: A General Principle of EU Law?', in: U. Bernitz, J. Nergelju and C. Cardner (eds.), 'General Principles of EC Law in a Process of Development', Alphen aan den Rijn: Kluwer Law International, 2008, p. 205, who relate the principle of transparency not only to the principle of democracy, but also to the right to be heard and the rights of defense.

<sup>111</sup> Legitimacy is understood in the sense that the regulator may be independent, but only if it is guaranteed that the regulator will provide insight in its actions. In that way, being transparent legitimises the independence of the regulator, see M. Aelen (2014), *Beginnelsen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, 2014, p. 333.

<sup>112</sup> According to Aelen, transparency contributes to effective regulation in different ways. For example, publication of monitoring information by the regulator contributes to transferring the applicable norms to regulated parties – thereby possibly achieving a higher rate of compliance; see M. Aelen (2014), *Beginnelsen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, 2014, pp. 333–334.

In EU (case) law, several aspects of the principle of transparency have been recognized, such as the right of access to documents,<sup>113</sup> and the ECJ refers to the ‘general principle of transparency’ in the field of public service concessions.<sup>114</sup>

The definition given by Hancher, Larouche and Lavrijssen thoroughly denotes the requirements which this principle imposes upon economic regulation in the drinking water sector: the regulatory authority needs to be “open with stakeholders about their objectives, processes, record and decisions. Moreover, authorities should explain to the citizens and the regulated firms the rationales of their decisions. Given that authorities are liable to be “captured” (at least as far as their attention and their information is concerned) by the regulated firms, the principle of transparency could even go as far as to require authorities actively to seek the involvement of other interests, in particular customers and citizens, in their activities.”<sup>115</sup>

In light of this definition, the principle of transparency requires transparency of the processes which lead to actions and decisions of the regulatory authority in the drinking water sector. Transparency of the accountability processes is equally required. Whereas transparency requires openness from the regulator, the principle of transparency could play a role in verifying whether economic regulation complies with other principles of good regulation.<sup>116</sup>

#### 5.4. PARTICIPATION

From the definition of the principle of transparency, a transition to the principle of participation is easily made.<sup>117</sup> For the drinking water sector, the principle of participation entails that participation of all stakeholders is essential to benefit economic regulation. Stakeholders include both domestic and non-domestic users, consumer organizations, lobby groups, NGOs and any other party holding a stake in

<sup>113</sup> Codified in Articles 41 and 42 of the EU Charter of Fundamental Rights.

<sup>114</sup> ECJ 13 September 2007, *Commission v Italy*, C-260/04, ECLI:EU:C:2007:508 par. 25.

<sup>115</sup> L. Hancher, P. Larouche and S. Lavrijssen (2004), ‘Principles of Good Market Governance’, *Tijdschrift voor Economie en Management*, vol. XLIX issue 2, 2004, p. 343.

<sup>116</sup> S. Prechal (2008), ‘De emancipatie van ‘het algemene transparantiebeginsel’, found at <[www.recht.nl/vakliteratuur/familierecht/artikel/164557/de-emancipatie-van-het-algemene-transparantiebeginsel/](http://www.recht.nl/vakliteratuur/familierecht/artikel/164557/de-emancipatie-van-het-algemene-transparantiebeginsel/)>, p. 10.

<sup>117</sup> See for more information on this principle, S. Lavrijssen (2006), ‘Onafhankelijke mededingingstoezichthouders, regulerende bevoegdheden en de waarborgen voor good governance’, Den Haag: Boom Juridische uitgevers, 2006, pp. 57–58; H. Addink (2005), ‘Principles of Good Governance: Lessons from Administrative Law’, in: D. Curtin and R. Wessel (eds.), *Good Governance and the European Union – Reflections on Concepts, Institutions and Substance*, Antwerp – Oxford – New York: Intersentia, 2005, p. 39; and J. Mendes, ‘Participation in EU Rulemaking. A Rights-based Approach’, Oxford: Oxford University Press, 2011; and A. Alemanno (2013), ‘Unpacking the Principle of Openness in EU Law – Transparency, Participation and Democracy’, p. 13.

the drinking water sector.<sup>118</sup> This principle has been acknowledged implicitly by the ECJ. In *Council v Access Info Europe* for instance, the ECJ notes in respect of the right of access to documents, that access to documents “enables citizens to participate more closely in the decision-making process.”<sup>119</sup> Participation is also referred to in Article 11 TEU.

Alemanno argues that since the principle of participation has found a base in the Treaties – most notably in Article 11 TEU<sup>120</sup> – ‘judicialization’ of participatory requirements by the ECJ can be awaited.<sup>121</sup> According to the Commission, “improved participation is likely to create more confidence in the end result.”<sup>122</sup> Creating more confidence in the end result thus entails participation in the process leading to that result. Nevertheless, it should be noted that the predominantly soft law nature of participation has as consequence that its abilities to legitimize a regulatory outcome by increasing the acceptance of the outcome could be limited.<sup>123</sup> In this regard, enforceable rights of participation are better placed to increase the legitimacy of regulatory outcomes.

## 5.5. EFFECTIVE LEGAL PROTECTION

Given that legal accountability towards stakeholders gives stakeholders the chance to address potential violations of their rights at the judiciary, the link between effective legal protection and the principle of accountability is a given. As a result, effective legal protection is also referred to as judicial or legal accountability.<sup>124</sup>

In *Johnston*, the ECJ stated that the principle of effective legal protection,<sup>125</sup> which is also enshrined as a right in Article 47 of the EU Charter of Fundamental Rights and in Articles 6 and 13 ECHR, is a general principle of EU law.<sup>126</sup> Since then, the ECJ

<sup>118</sup> For a definition of a stakeholder, see S. Lavrijssen (2006), *Onafhankelijke mededingingstoezichhouders, regulerende bevoegdheden en de waarborgen voor good governance*, Den Haag: Boom Juridische uitgevers, 2006, p. 30.

<sup>119</sup> ECJ 17 October 2013, *Council v Access Info Europe*, C-280/11 P, ECLI:EU:C:2013:671, par. 32.

<sup>120</sup> See also J. Mendes (2011), ‘Participation and the Role of Law after Lisbon: A Legal View on Article 11 TEU’, *Common Market Law Review*, Vol. 48 number 6, 2001, pp. 1849–1878.

<sup>121</sup> A. Alemanno (2013), ‘Unpacking the Principle of Openness in EU Law – Transparency, Participation and Democracy’, p. 17.

<sup>122</sup> European Commission (2001), *European governance – a white paper*, COM(2001) 428 final, p. 7.

<sup>123</sup> A. Alemanno (2013), ‘Unpacking the Principle of Openness in EU Law – Transparency, Participation and Democracy’, p. 15.

<sup>124</sup> See M. Bovens (2006), ‘Analysing and assessing public accountability. A conceptual framework’, *European Law Journal* 2006, 13(4), p. 447–468.

<sup>125</sup> For more on this principle see K. Lenaerts, ‘Effective Judicial protection in the EU’, 2013, found at <<http://ec.europa.eu/justice/events/assises-justice-2013/files/interventions/koenlenarts.pdf>>; and R. Widdershoven (2011), ‘Het beginsel van effectieve rechtsbescherming’, found at <<http://dspace.library.uu.nl/handle/1874/241777>>.

<sup>126</sup> ECJ 15 May 1986, *Johnston v Chief Constable of the Royal Ulster Constabulary*, C-222/84, ECLI:EU:C:1986:206, par. 18.

regularly underlines that effective legal protection is necessary to enforce the rights that parties derive from EU law and which are affected by decisions of national regulatory authorities.<sup>127</sup> In principle, effective legal protection is offered by the judiciary, which examines whether one's rights have been violated. Scrutiny by an independent third party – the judiciary – is vital, as otherwise, granted rights would be empty.

## 5.6. EFFECTIVENESS

The consequences for economic regulation which flow from the principle of effectiveness, come from the principle of effectiveness as a principle of good regulation. This principle of good regulation needs to be distinguished from the principle of effectiveness, often referred to by the ECJ in its case law concerning the application of EU law in national legal orders.<sup>128</sup>

The Commission states that the principle of effectiveness as a principle of good regulation entails that “policies must be effective and timely, delivering what is needed on the basis of clear objectives, an evaluation of future impact and, where available, of past experiences. Effectiveness also depends on implementing EU policies in a proportionate manner and on taking decisions at the most appropriate level.”<sup>129</sup> This definition shows that the principle of effectiveness is non-binding. Nonetheless, the definition indicates that effectiveness should act as an obligation resting upon both legislator and regulator when drafting legislation, policies and taking decisions.<sup>130</sup>

The national dimension of the principle of effectiveness as a principle of good regulation, is not shaped from an ‘obligation imposing’ viewpoint. Rather, it starts from the viewpoint that the government serves the public interests.<sup>131</sup> This starting point leads to the interpretation of the principles of effectiveness as a requirement that public intervention must be efficient and effective.<sup>132</sup>

<sup>127</sup> See for example ECJ 21 February 2008, *Tele2 Telecommunication*, C-426/05, ECLI:EU:C:2008:103, par. 30 and 32.

<sup>128</sup> In that context, the principles of effectiveness implies that national procedural laws may not render the exercise of rights flowing from EU law “practically impossible or excessively difficult”, see ECJ 8 July 2010, *Bulicke*, C-246/09, ECLI:EU:C:2010:418, par. 25; and M. Aelen (2014), *Beginselen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, 2014, p. 153.

<sup>129</sup> European Commission (2001), *European governance – a white paper*, COM(2001) 428 final p. 7.

<sup>130</sup> M. Aelen (2014), *Beginselen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, 2014, p. 153; see also OECD (2012), *Recommendation of the Council on Regulatory Policy and Governance*, p. 13.

<sup>131</sup> M. Aelen (2014), *Beginselen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, 2014, pp. 153–154.

<sup>132</sup> *Ibid.*, pp. 153.

## 6. ASSESSMENT OF THE CURRENT FORM OF REGULATION OF THE DRINKING WATER SECTOR IN LIGHT OF PRINCIPLES OF GOOD REGULATION

Now that the most relevant principles of good regulation have been set out for economic regulation of the drinking water sector, the current form of economic regulation will be assessed. In the assessment of economic regulation, weaknesses in light of the principles of good regulation will be discussed regarding the different phases of the regulatory process, i.e. the tariff, the benchmark, the WACC, the maximum percentage of equity and the financial oversight.

### 6.1. INDEPENDENCE

As has come forward in paragraph 5.1, the principle of independence is comprised of two elements: independence from market parties and political independence. Observance of these two elements is not reflected in economic regulation of the drinking water sector.

In the process of tariff setting, shareholders of the drinking water companies are exclusively competent to approve the drinking water tariff.<sup>133</sup> Together with the Minister of I&E, they are responsible for (part of) the financial oversight. Whereas shareholders (the provinces and municipalities) are not independent from the drinking water companies – and thus politics is not independent from the market – a conflict of interest may arise in the determination of the tariff.<sup>134</sup> This organization of economic regulation neither guarantees political independence, nor independence from the market.

Political independence of the economic regulator offers certain advantages, such as the prevention of conflicts of interests and avoidance of prevalence of short-term, political interests in regulation of the drinking water sector. Considering this, sufficient political independence could prove very useful.<sup>135</sup> Likewise, a certain degree of political independence to take regulatory decisions – like tariff setting – has a positive effect on attracting investments and fostering innovation, as it increases the likelihood of consistent economic regulation based on the needs of the market.<sup>136</sup> In the Dutch drinking water sector, however, economic regulation is not politically

<sup>133</sup> Article 20 Drinking Water Act.

<sup>134</sup> See in this regard also K. De Witte & D. Saal, 'Is a little sunshine all we need? On the impact of sunshine regulation on profits, productivity and prices in the Dutch drinking water sector', *Journal of Regulatory Economics*, June 2009, also available via [www.researchgate.net](http://www.researchgate.net), p. 8.

<sup>135</sup> See in this regard also OECD (2014), *The Governance of Regulators*, pp. 50–51.

<sup>136</sup> L. Hancher, P. Larouche and S. Lavrijssen (2004), 'Principles of Good Market Governance', *Tijdschrift voor Economie en Management*, vol. XLIX issue 2, 2004, p. 344; S. Lavrijssen and A. Ottow, 'The legality of independent regulatory authorities', p. 73–95; P. Larouche (2014), 'CERRE, Code of Conduct and Best Practices for the setup, operations and procedure of regulatory authorities',

independent since the Minister of I&E and the Inspectorate are both part of the Ministry of I&E.

Also by letting shareholders have the final say on the tariff, the risk arises that short-term political interests of the decentralized governments will prevail.<sup>137</sup> A conflict of interest arises when the shareholders of the drinking water companies need to act in the interest of the user in setting the tariff. Considering their capacity as municipality or province, there is a risk that shareholders might give less priority to the (long term) interests of users of water.<sup>138</sup> An example may be the sufferance tax levied by municipalities in their capacity as municipalities. This sufferance tax is paid by drinking water companies, who pass it on to their users. The decision of municipalities to charge such a tax may be at odds with the role of municipalities as shareholders – in the latter position they ought to make sure that users of drinking water pay affordable drinking water tariffs. However, in taking the decision with regard to the sufferance taxes, the municipalities may let their financial interests prevail.

Independence from market parties is at stake in the execution of the benchmark. Due to the lack of solid safeguards, stakeholders are provided insufficient guarantees that a party independent from the drinking water companies assesses their performance. On the basis of the Drinking Water Act, the Inspectorate is responsible for carrying out the triennial performance comparison.<sup>139</sup> Initially, execution of the benchmark was left to Vewin, the Association of Dutch Water Companies.<sup>140</sup> The Inspectorate has issued the *'Protocol Performance Comparison Drinking Water Companies 2012'* concerning the content and set-up of the benchmark. There, the Inspectorate stated that it will monitor correct observance of the protocol and the presentation of the data.<sup>141</sup> There was however no explanation of which measures were available to ensure compliance with the protocol, or of how the Inspectorate monitored observance of the protocol.

Following consultation with the water companies and Vewin, the Minister of I&E adopted the *'Protocol performance comparison drinking water companies 2015'*. This protocol will be used in the performance comparison of 2015. Compared to the *'Protocol Performance Comparison Drinking Water Companies 2012'*, the new protocol allows for clearer division of roles. The fact that the Protocol indicates for example

p. 13; and S. Lavrijssen (2006), *Onafhankelijke mededingingstoezichthouders, regulerende bevoegdheden en de waarborgen voor good governance*, Den Haag: Boom Juridische uitgevers, 2006, pp. 9–10.

<sup>137</sup> See T. Christensen and P. Lægrend (2005), 'Regulatory Reforms and Agencification', *3<sup>rd</sup> ECPR Conference*, pp. 20–21.

<sup>138</sup> See in this regard also E. van Damme and K. Mulder, 'Transparant en eerlijk geprijsd water', *ESB* 24–3–2006, p. 135; see also M. Blokland, M. Schouten and K. Schwartz, 'Rejuvenating a Veteran Benchmarking Scheme: Benchmarking in the Dutch Drinking Water Sector', *Competition and Regulation in Network Industries*, 2010–2, pp. 147–148.

<sup>139</sup> Article 48(1) Drinking Water Act.

<sup>140</sup> Inspectorate, *'Protocol Prestatievergelijking Drinkwaterbedrijven 2012'*, p. 26.

<sup>141</sup> *Ibid.*, pp. 6 and 26.



that the Inspectorate prepares the report, is an improvement in light of the independence of the market parties. However, the role of Vewin in the benchmark remains considerable, since it remains responsible for the facilitation of the delivery of the data and the standardization of this data. Since Vewin is not independent from the drinking water companies, there is still room for improvement in light of the principle of independence.

The OECD has also identified the need for more independence, as it calls for “independent oversight, at an arm’s length from water institutions.”<sup>142</sup> Four concrete limitations of the current benchmark were addressed by the OECD to underpin its call for ‘independent oversight’ on drinking water companies. These limitations are (i) “the decreased number of reference observations in the benchmark [which] likely reduces the potential effectiveness of benchmarking in identifying underperformance”; (ii) “the lack of a third-party involvement in service quality performance assessment or monitoring [which] is all the more challenging when there is a reduced number of players with higher risks of monopolistic behaviour”; (iii) “[that] the information and capacity asymmetry between companies and their shareholders to understand common assessments related to the annual approved investment packages and criteria for decision making can be a challenge”; and (iv) “[that] investments considered as ‘technically essential’ by companies may not be understood (or further investigated) by their public shareholders. In such cases, an independent authority that would carry out the benchmark exercise and use results to set tariffs may help to avoid the vicious circles of under-investment or expensive technological or infrastructure options, and achieve better water demand management and more environmentally friendly innovations.”<sup>143</sup>

## 6.2. ACCOUNTABILITY

Whereas the Minister of I&E is accountable to Parliament, the Minister needs to be fully informed about the activities and performances of the drinking water companies. However, successful accountability requires transparency.<sup>144</sup> The fact that the Inspectorate was unable to assess the cost-effectiveness of the drinking water tariffs because the drinking water companies did not make clear how the costs were

<sup>142</sup> OECD (2014), ‘*Water Governance in the Netherlands: Fit for the Future?*’, p. 257–258.

<sup>143</sup> OECD (2014), ‘*Water Governance in the Netherlands: Fit for the Future?*’, p. 252; with the latter two arguments, the OECD exposes the information asymmetry existing between the shareholders and the management of the drinking water companies. A lack of expertise on the side of the decentralised municipalities, may lead to under- or over investment as the decentralised municipalities are not in the position to assess whether proposed investments presented by the management are necessary; neither are they in the position to recognise which investments in the drinking water companies are necessary.

<sup>144</sup> See in this regard also M. Aelen (2014), *Beginselen van goed markttoezicht – Gedefinieerd, verklaard en uitgewerkt voor het toezicht op de financiële markten*, Den Haag: Boom Juridische uitgevers, 2014, p. 361.



incorporated in their tariffs,<sup>145</sup> testifies that political accountability is limited by a lack of transparency.

As has been seen in the second paragraph, the political accountability relations in the drinking water sector are also hampered by the variety of players involved in the drinking water sector. In that regard, it may be noted that in the current situation, the Minister of I&E and the Inspectorate render insufficiently account for their acts – such as the decision to set the WACC and the maximum percentage of equity – to stakeholders. The Inspectorate is accountable to the Minister of I&E who renders account to the Parliament, that represents the citizens – the latter including stakeholders in the drinking water sector. During elections, citizens can base their vote on their stance concerning economic regulation of the drinking water sector. For example on the basis of information obtained on national accountability day which takes place every year. On this day, the Ministry of I&E provides the Parliament with a publicly available annual report in which it explains whether and how the Ministry's pre-set objectives have been achieved.<sup>146</sup> However, this is a rather remote way of rendering account as it gives stakeholders hardly an opportunity to make their position known to the Minister of I&E or to the Inspectorate. Due to this remoteness, information from stakeholders regarding the obtained results of economic regulation, the way in which implemented policies are perceived and whether reorientation is desired according to stakeholders is less likely to reach the Minister of I&E, the Inspectorate and ultimately Parliament.

A similar drawback considering accountability exists between the drinking water companies and ultimately the stakeholders. Whereas theoretically, drinking water users can hold the shareholders of the drinking water companies accountable during municipal or provincial elections – the shareholders are democratically elected municipalities and provinces – this is not an effective accountability mechanism. The electorate votes on the entire set of political policies of the last four years pursued by the decentralized government. Considering this, the vote of the electorate is too indirect to be led back to feedback on the shareholders of the drinking water companies. Moreover, other factors further complicate this type of accountability. For example, the supply areas of the drinking water companies do not coincide with municipal or provincial borders.<sup>147</sup> This means that there are cases imaginable where a user of drinking water wishing to use his vote during provincial or municipal elections to express his (dis)satisfaction with a shareholder of his drinking water company, cannot do so because he is not allowed to vote in the province or municipality that is the shareholder.

<sup>145</sup> Inspectorate, 'Toezicht Drinkwatertarieven – Beoordeling tarieven 2012', p. 10.

<sup>146</sup> See for the most recent report of the Ministry of I&E <[www.rijksoverheid.nl/onderwerpen/verantwoordingsdag/verantwoordingsdagstukken](http://www.rijksoverheid.nl/onderwerpen/verantwoordingsdag/verantwoordingsdagstukken)>; this annual report, the Ministry of Infrastructure and Environment – of which the Inspectorate is part – gives account for the expenditures, income and commitments compared to the budget of the Ministry.

<sup>147</sup> See annex 1 to the Drinking Water Regulation.

The identified lack of transparency also creates an information gap between stakeholders and the regulator which acts as an obstacle in the process of rendering account. This is a pity, as this type of social accountability may eminently be suited to create public support and acceptance of regulatory actions.<sup>148</sup> Exemplary for this is the benchmark. Where drinking water companies are meant to be accountable to stakeholders by way of the benchmark,<sup>149</sup> the benchmark as accountability mechanism falls short. Firstly, shareholders are not obliged to use the benchmark in their supervision of the drinking water company. Secondly, other stakeholders, such as captive users of drinking water, end up empty-handed: they cannot induce changes on the basis of the benchmark results. Neither can they switch to a better performing drinking water company to 'punish' underperforming drinking water companies. Only the drinking water companies are in the position to actually address potential shortcomings revealed by the performance comparison. The results of the benchmark are thus not given sufficient weight in the accountability process between drinking water companies and stakeholders.

### 6.3. TRANSPARENCY

The Drinking Water Act stipulates that the tariff for drinking water has to be "cost-effective, transparent and non-discriminatory."<sup>150</sup> In order to guarantee this, detailed transparency requirements are written down in law. However, transparency requirements regarding the drinking water tariffs<sup>151</sup> – applicable to all drinking water companies – are poorly met in practice.

Each drinking water company is obliged to publish an overview of their drinking water tariffs with a specification that shows how their tariffs are derived from their operational costs, depreciation costs, costs of capital and taxation costs.<sup>152</sup> Consultation of the available overviews for 2014 shows that *not one* of the drinking water companies indicated the relation between the costs and the tariffs, as required by Article 10(3) Drinking Water Decision.<sup>153</sup>

<sup>148</sup> See in this regard sub-paragraph 5.2 'Accountability' of this article.

<sup>149</sup> Vewin (2013), '*Water in Zicht 2012 – Bedrijfsvergelijking drinkwatersector*', Vereniging van waterbedrijven in Nederland, Rijswijk, Netherlands, p. 12.

<sup>150</sup> Article 11(1) Drinking Water Act.

<sup>151</sup> Article 10 Drinking Water Decision.

<sup>152</sup> Article 10(3) Drinking Water Decision.

<sup>153</sup> NV Waterbedrijf Groningen, '*Tarievenregeling per 1 januari 2014*', found at <[www.waterbedrijfgroningen.nl/wp-content/uploads/2014/09/Tarievenregeling-2014.pdf](http://www.waterbedrijfgroningen.nl/wp-content/uploads/2014/09/Tarievenregeling-2014.pdf)>; NV Waterleidingmaatschappij Drenthe, '*Tarievenregeling NV Waterleidingmaatschappij Drenthe 2014*', found at <[www.wmd.nl/sites/default/files/uploads/WaterThuis/TariefEnNota/472-04\\_tarievenregeling2014.pdf](http://www.wmd.nl/sites/default/files/uploads/WaterThuis/TariefEnNota/472-04_tarievenregeling2014.pdf)>; Vitens NV, '*Tarievenoverzicht Consumenten 2014*', found at <[www.vitens.nl/overvitens/organisatie/Documents/Tarieven%202014/Drinkwatertarieven%20Vitens%20Consumenten%202014.pdf](http://www.vitens.nl/overvitens/organisatie/Documents/Tarieven%202014/Drinkwatertarieven%20Vitens%20Consumenten%202014.pdf)>; Oasen NV, '*Tarievenlijst 2014*', found at <[https://www.oasen.nl/Lists/Downloads/Tarievenoverzicht\\_drinkwater\\_2014.pdf](https://www.oasen.nl/Lists/Downloads/Tarievenoverzicht_drinkwater_2014.pdf)>; Stichting Waternet, '*Vaststelling Tariefbepaling 2014*',

Similarly, also information obtained in the process of the benchmark suffers from a lack of transparency, despite that the benchmark is presented as a means to provide openness to stakeholders.<sup>154</sup> While the *Protocol Performance Comparison Drinking Water Companies 2012* issued by the Inspectorate provides insight on what information needs to be delivered by the drinking water company, this information is not made public. In this regard, it must be noted that only the end-report – containing the results of the benchmark – is publicly available. This end-report does not show the structure of the categories of costs of the drinking water companies. As a consequence, it is not possible to verify the information upon which the costs are calculated. Therefore, it is not transparent which information forms the basis of the benchmark.<sup>155</sup>

A confirmation of the general lack of transparency in economic regulation can be found in the results of financial oversight. In a report concerning the tariffs of drinking water in 2012 – containing a separate assessment of each drinking water company<sup>156</sup> – the Inspectorate<sup>157</sup> concluded that none of the drinking water companies could make sufficiently clear how the costs were incorporated in the 2012 drinking water tariffs.<sup>158</sup>

Thus, on crucial points like the composition of the tariffs and the performance comparison, a lack of transparency comes forward. A study has shown that it is possible that users of drinking water are charged too high a tariff for drinking water.<sup>159</sup> A lack of transparency only further increases the risk of overpayment by users of drinking water.

#### 6.4. PARTICIPATION

It is striking that stakeholder participation is virtually absent in economic regulation of the drinking water sector. Users, lobby groups, consumers groups and experts have

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found at <[https://www.waternet.nl/media/647985/tariefbepalingen\\_dw\\_2014.pdf](https://www.waternet.nl/media/647985/tariefbepalingen_dw_2014.pdf)>; NV PWN Waterleidingbedrijf Noord-Holland, *Tarieven en betaling*, found at <<https://www.pwn.nl/tarieven>>; Dunea Duin & Water, *Tarievenregeling 2014*, found at <<https://www.dunea.nl/klantenservice/tarieven>>; Evides NV, *Tarievenregeling 2014*, found at <[www.evides.nl/klantenservice/Documents/Brochures/Evides%20Tarievenregeling%202014.pdf](http://www.evides.nl/klantenservice/Documents/Brochures/Evides%20Tarievenregeling%202014.pdf)>; Brabant Water NV, *Tarievenregeling*, found at <[www.brabantwater.nl/SiteCollectionDocuments/Tarievenregeling\\_2014-aangepast.pdf](http://www.brabantwater.nl/SiteCollectionDocuments/Tarievenregeling_2014-aangepast.pdf)>; Nv WML, *Tarief 2014*, found at <[www.wml.nl/nl-nl/158/6336/tarief-2014.aspx](http://www.wml.nl/nl-nl/158/6336/tarief-2014.aspx)>.

<sup>154</sup> Vewin (2013), *Water in Zicht 2012 – Bedrijfsvergelijking drinkwatersector*, Vereniging van waterbedrijven in Nederland, Rijswijk, Netherlands, p. 12.

<sup>155</sup> See in this regard also the OECD who noted that “transparency provides opportunities during all phases of the policy cycle to ‘measure’ each other’s performance, draw lessons and adjust implementation accordingly. Public disclosure of data underlying benchmarks should thus be encouraged,” OECD (2014), *Water Governance in the Netherlands: Fit for the Future?*, p. 258.

<sup>156</sup> Inspectorate, *Toezicht Drinkwatertarieven – Beoordeling tarieven 2012*.

<sup>157</sup> Based on research and advice of the ACM, see Inspectorate, *Toezicht Drinkwatertarieven – Beoordeling tarieven 2012*, annex D.

<sup>158</sup> Inspectorate, *Toezicht Drinkwatertarieven – Beoordeling tarieven 2012*, p. 10.

<sup>159</sup> E. van Damme and K. Mulder, ‘Transparant en eerlijk geprijsd water’, *ESB* 24–3–2006, p. 135.

no formal possibility to play a role in economic regulation of the drinking water sector.

Only in the demarcation of the WACC rate, there is a minor role for stakeholder involvement. For this demarcation, the Minister of I&E is required to seek advice from the ACM.<sup>160</sup> In preparation of its advice, the ACM offers the chance to stakeholders to submit their point of view regarding the proposed WACC rate.<sup>161</sup> The ACM gives its reaction on the viewpoints and notes that it takes them into account.<sup>162</sup> The way in which this is done, however, is not explained. That stakeholders involvement remains this insignificant, is unfortunate as the advice of the ACM has important consequences for economic regulation of the drinking water sector. It has been seen in the second paragraph that the Minister of I&E and the Inspectorate consistently adopt the advice from the ACM.<sup>163</sup>

Therefore, the current form of stakeholder participation is weak. Stakeholders do not know which role their viewpoint plays in the process of advising the Minister of I&E. Furthermore, they cannot ask a court to review whether their point of view has been taken into account and neither can they ask an administrative court to review the decision by which the rate for the WACC is adopted (see also below). This is because both the advice of the ACM and the decision concerning the WACC rate taken by the Minister of I&E are not appealable.<sup>164</sup>

Because stakeholder participation comes close to non-existing, economic regulation does not benefit from the input of users, interest groups, experts and other stakeholders which can enhance the quality and effectiveness of the regulation. Moreover, neither the role of user participation as a way to achieve more legitimacy of the process of tariff setting by the drinking water companies, due to weak social accountability, is achieved.

## 6.5. EFFECTIVE LEGAL PROTECTION

In the current organization of the drinking water sector, effective legal protection is seriously compromised. Stakeholders have little possibilities to directly refer a case to a (specialized) administrative court. This follows from the fact that the decision of the Minister to set the WACC is not appealable.<sup>165</sup> Neither the tariff decisions of the drinking water companies are appealable, as these decisions can be considered private

<sup>160</sup> Article 8a Drinking Water Decision in conjunction with Article 7 Drinking Water Regulation.

<sup>161</sup> See <<https://www.acm.nl/nl/publicaties/publicatie/12061/Vermogenskostenvoet-Drinkwaterbedrijf-2014-2015/>>.

<sup>162</sup> See <<https://www.acm.nl/nl/publicaties/publicatie/12061/Vermogenskostenvoet-Drinkwaterbedrijf-2014-2015/>>.

<sup>163</sup> See footnote 41.

<sup>164</sup> See Article 10(3) Drinking Water Act, which stipulates that the decision of the Minister of I&E regarding the determination of the WACC rate is not appealable.

<sup>165</sup> Article 10(3) Drinking Water Act.

acts and do not entail administrative acts. Also the advisory role of the ACM undermines the possibilities for effective legal protection as the advice has no legal effects and accordingly, stakeholders do not benefit from effective legal protection because of a lack of legal standing at the administrative court. In case the ACM would be empowered to adopt decisions, stakeholders would perhaps have a chance to directly challenge acts of the ACM in the administrative court and to hold it judicially accountable.

In the current situation, the decision of the Minister to set the WACC on the basis of advice of the ACM or the tariff decisions of the drinking water companies can only be challenged indirectly. For example in civil proceedings against drinking water companies based on tort law in which it is claimed that the prices are excessive and amount to a violation of Article 102 TFEU. This, however, is a burdensome route for the users due to the heavy burden of proof and the costs of civil proceedings. By addressing a potential abuse of a dominant position of a drinking water company at the ACM in its capacity as competition authority, a user may also seek legal protection. In order to ask from the ACM to take a decision on whether the drinking water company abuses its dominant position, the user needs to be legally qualified as an ‘interested party’.<sup>166</sup> In general, individuals are not easily granted the status of ‘interested party’. Consumer organizations that are representative organizations on the other hand, do receive the status of ‘interested party’ if their interests are deemed to include the general and collective interests which they particularly represent in accordance with their objects and as evidenced by their actual activities.<sup>167</sup> Alternatively, dispute resolution committees – like the Disputes Resolution Committee on Water<sup>168</sup> – may also play a role in offering legal protection to the water users.<sup>169</sup>

While the Disputes Resolution Committee on Water offers clear advantages to drinking water users – it acts for example more swiftly and costs less than judicial dispute resolution by a court –<sup>170</sup> these benefits do not justify the absence of judicial review by an independent administrative judge. The Disputes Resolution Committee on Water is only competent to settle disputes between users and drinking water companies that relate to the establishment or implementation of contracts concerning

<sup>166</sup> Article 1:2(1) General Administrative Law Act.

<sup>167</sup> Article 1:2(3) General Administrative Law Act.

<sup>168</sup> <[www.degeschillencommissie.nl/over-ons/de-commissies/2779/water](http://www.degeschillencommissie.nl/over-ons/de-commissies/2779/water)>.

<sup>169</sup> For more on alternative dispute resolution, see S. Blake and J. Browne (2012), ‘A Practical Approach to Alternative Dispute Resolution’, Oxford: Oxford University press, 2012; see for an outline of cases from the Dutch Dispute Resolution Committee Energy and water, W. H. van Boom, *Energie en Water*, TvC 2010, pp. 3–19; E. Hondius (2011), ‘De geschillencommissies’, in: E. H. Hondius and G. J. Rijken, *Handboek consumentenrecht*, Zutphen: Uitgeverij Paris, pp. 535–555; M.B.M. Loos and W. H. van Boom (2010), *Handhaving van het consumentenrecht*, Deventer: Kluwer, 2010.

<sup>170</sup> Europese Commissie (2011), *Alternative Dispute Resolution and Online Dispute Resolution for EU consumers: Questions and Answers*, memo 11/840; en Geschillencommissie Water, ‘Hoe werkt de Geschillencommissie Water’, beschikbaar via <[www.degeschillencommissie.nl/userfiles/BTW\\_Brochures/WTR%20\(SGC\)%20brochure\\_140619.pdf](http://www.degeschillencommissie.nl/userfiles/BTW_Brochures/WTR%20(SGC)%20brochure_140619.pdf)>.

the connection to and/or the supply of drinking water.<sup>171</sup> This means that the Disputes Resolution Committee on Water cannot give a ruling on the WACC, the maximum percentage of equity of drinking water companies and the determination of the drinking water tariff. Hence, the existence of the Dispute Resolution Committee on Water does not take away the importance of the possibility to refer a case to the Appeals Tribunal for Trade and Industry.<sup>172</sup> The Appeals Tribunal for Trade and Industry, is the highest administrative court for economic regulation in the Netherlands. It is competent to decide on regulatory issues in other network sectors, such as the determination of a tariff or a WACC rate in the energy sector. To guarantee effective legal protection, it is important that ultimately an independent administrative court may review regulatory decisions that affect the interests of the water users.

The lack of effective legal protection considerably affects the credibility of good economic regulation of the drinking water sector. It takes away the possibility of direct legal scrutiny of acts of the Minister and the ACM by an independent administrative court. In the absence of the possibility of direct administrative appeal against essential elements of the drinking water tariffs, stakeholders have little chance to hold the Minister of I&E, the Inspectorate and the drinking water companies judicially accountable for their acts.

#### 6.6. EFFECTIVENESS

Whereas economic regulation does not fully respect the above discussed principles, it is difficult to assess whether the way in which financial oversight is organized, the drinking water tariff and the WACC rate are determined, are effective in reaching the aim of “cost-effective, transparent and non-discriminatory” drinking water tariffs.<sup>173</sup> According to the Drinking Water Decision, cost-effectiveness is realized when the drinking water’s forecasted turnover from the drinking water tariff does not exceed the sum of the estimated costs.<sup>174</sup>

However, the finding of the Inspectorate that the composition of the drinking water tariffs of 2012 is unclear,<sup>175</sup> indicates that the current organization of economic regulation provides for insufficient safeguards to effectively protect users against excessive tariffs. Moreover, the earlier mentioned point – that the adoption of necessary improvements based on the benchmark results to achieve cost-effectiveness and transparent tariffs depend for a large part upon the intentions of the drinking water companies – also shows that there is still room for improvement regarding the effectiveness of the benchmark.

<sup>171</sup> Artikel 3 Reglement Geschillencommissie Water.

<sup>172</sup> Zie ook H. J. Snijders (2010), ‘Arbitrage en/of bindend advies bij de SGC – Een onderzoek in opdracht van de Coördinatiegroep Zelfreguleringsoverleg van de Sociaal-Economische Raad’.

<sup>173</sup> Article 11(1) Drinking Water Act.

<sup>174</sup> Article 9(3) Drinking Water Decision.

<sup>175</sup> Inspectorate, ‘Toezicht Drinkwatertarieven – Beoordeling tarieven 2012’, p. 10.

Observance of in particular the principles of transparency, accountability, independence and participation play a crucial role in attaining effective economic regulation that safeguards the public interest. These principles make it possible to ascertain whether and how economic regulation attains the public aims it pursues. At the same time, observance of these principles may expose necessary changes to make economic regulation more effective.

## 6.7. SUMMARY

While an important role in supervising the drinking water companies is reserved for the shareholders of the drinking water companies, independence from market parties is insufficiently guaranteed. This is because the shareholders – by setting the drinking water tariff – are not independent from, but part of the market party they supervise. The considerable role of Vewin, the association of the Dutch drinking water companies, in the benchmark, is another factor which compromises the independence of economic regulation. Next to this, economic regulation does not benefit from political independence as the Minister of I&E and the Inspectorate are responsible for the financial supervision, the determination of the WACC and the maximum percentage of equity.

These concerns regarding the independence of economic regulation are closely related to the general lack of transparency. Opaqueness regarding the preparation and the consequences of the benchmark call into question its independence in practice. Moreover, transparency requirements are insufficiently observed by the drinking water companies regarding tariffs as they do not provide sufficient insight in how the tariff is derived from their costs. This has been confirmed by the Inspectorate in its assessment of the drinking water tariffs of 2012. Therefore, users of drinking water are given insufficient insight in the exact composition of the drinking water tariff.

It is striking that participation of stakeholders such as users of drinking water, interest groups and experts plays virtually no role in economic regulation of the drinking water sector. The Drinking Water Act does not provide for forms of participation of stakeholders. Only the ACM gives stakeholders the chance to submit viewpoints regarding a proposed advice, but the role of these submitted viewpoints in the process of giving advice is not clarified. Therefore, possible advantages of user participation, such as improvement of the quality of decisions and more support for regulatory decisions, are still largely neglected in the drinking water sector.

The general lack of transparency, the unchallengeable nature of the decision of the Minister of I&E to fix the rate for the WACC and the fact that it is left to drinking water companies to set the tariffs and to decide what consequences should be attached to the results of the benchmark considerably undermine effective legal protection of users of drinking water. Also the role of the ACM, the independent regulatory authority of the Dutch economy, undermines effective legal protection. Since the Minister of I&E and Inspectorate adopt the advice of the ACM consistently, effective legal protection is considerably hampered by the unchallengeable nature of advice of the ACM.



The current form of economic regulation displays too many gaps in light of the principles of good regulation. As a result, captive users of drinking water are insufficiently protected against potentially undesirable behavior of the drinking water companies.

## 7. OTHER FORMS OF ORGANIZATION OF ECONOMIC REGULATION: THE UK DRINKING WATER SECTOR AND THE DUTCH ENERGY SECTOR

Certain aspects of other forms of economic regulation may inspire economic regulation of the Dutch drinking water sector.<sup>176</sup> Therefore, this paragraph examines how the principles of independence and participation are reflected in economic regulation of the drinking water sector of the UK and the Dutch energy sector. These sectors are relevant for this research, as they have to some extent similar economic characteristics, related to the natural monopoly character of the transport infrastructures, as the Dutch drinking water sector. Both discussed models of economic regulation have undergone a transition in which independence and participation of users obtained a more central role in safeguarding good regulation.<sup>177</sup> The analysis of these changes may provide a source of inspiration for further debate on the improvement of good regulation in the Dutch drinking water sector.

### 7.1. UNITED KINGDOM'S WATER SECTOR

Like in the Netherlands, domestic users in the UK are captive users. Consequently, each drinking water company<sup>178</sup> is a monopolist.<sup>179</sup> Contrary to the situation in the Netherlands however, non-domestic users that use large amounts of water are not subject to these monopolies: they are in a position to choose their supplier.<sup>180</sup> In order to protect domestic users from the lack of competition, Ofwat acts as independent economic regulator of the drinking water sector.<sup>181</sup> The tasks entrusted to Ofwat are the protection of consumers, ensuring that the regulated companies can finance their

<sup>176</sup> See for more regulatory solutions of different countries also OECD (2015), 'The Governance of Water Regulators'.

<sup>177</sup> For other regulatory solutions that could act as a source of inspiration for the Dutch drinking water sector, reference is made to J. Wackerbauer, 'The Water Sector in Germany', Working paper CIRIEC no. 2009/11 and to B. Barraque & C. Le Bris, 'Water Sector Regulation in France', CESifo DICE Report 2/2007.

<sup>178</sup> In the UK, provision of water and sewerage services are frequently united in one company; for the purpose of this article, companies that also provide drinking water, are referred to as drinking water companies, despite the additional services they offer.

<sup>179</sup> See <[www.ofwat.gov.uk/pricereview/](http://www.ofwat.gov.uk/pricereview/)>.

<sup>180</sup> See <[www.ofwat.gov.uk/nonhousehold/choose/](http://www.ofwat.gov.uk/nonhousehold/choose/)>.

<sup>181</sup> See <[www.ofwat.gov.uk/pricereview/](http://www.ofwat.gov.uk/pricereview/)>.



functions and ensuring that the regulated companies perform their functions properly.<sup>182</sup> These aims largely correspond to the aims pursued by Dutch economic regulation of the water sector.<sup>183</sup>

The importance of independence of economic regulators is underlined in the ‘*Principles for Economic Regulation*’, a set of principles issued by the government which is in particular applicable to the network sectors, including the water sector.<sup>184</sup> There, the government states that “independent regulation has been a vital part of the UK’s framework for economic regulation since the 1980s and remains central to the UK government’s approach.”<sup>185</sup> According to the government of the UK, independence of regulation is necessary as it displays several advantages.<sup>186</sup> Independence is, for example, crucial and necessary to guarantee “stability and predictability of regulation and the concentration of regulatory expertise.”<sup>187</sup> Next to this, it also attracts investments and ensures that the consumer will only pay for efficient investments.<sup>188</sup>

In preparation of Ofwat’s price review of 2014 – to determine the price caps for the period 2015–2020<sup>189</sup> – far reaching user participation has been introduced in the UK’s (drinking) water sector.<sup>190</sup> Ofwat’s encouragement of user participation,<sup>191</sup> based on the awareness that users need to know whether their bills are “fair and legitimate”,<sup>192</sup> resulted in the adoption of customer challenge groups by each drinking water company. These customer challenge groups are composed of an independent

<sup>182</sup> Department for Environment, Food and Rural Affairs (2011), ‘*Review of Ofwat and consumer representation in the water sector*’, p. 5.

<sup>183</sup> See paragraph two of this paper.

<sup>184</sup> See Department for Business, Innovation and Skills (2011), ‘*Principles for Economic Regulation*’, point 4.

<sup>185</sup> Ibid, point 20.

<sup>186</sup> See for more advantages linked to independence of the regulator: Department for Business, Innovation and Skills (2011), ‘*Principles for Economic Regulation*’.

<sup>187</sup> Ibid, point 18.

<sup>188</sup> Ibid, points 18 and 23.

<sup>189</sup> The primary tool by which Ofwat regulates the drinking water companies, is by setting a price cap on the drinking water tariff. In order to determine these price limits, Ofwat undertakes a price review every five years. In these price reviews, the business plans for the next five years of the regulated companies are scrutinised by Ofwat; see Department for Environment, Food and Rural Affairs (2011), ‘*Review of Ofwat and consumer representation in the water sector*’, p. 9; and <[www.ofwat.gov.uk/pricereview/](http://www.ofwat.gov.uk/pricereview/)>.

<sup>190</sup> See <[www.ccwater.org.uk/waterissues/pr14/ccgpr14/](http://www.ccwater.org.uk/waterissues/pr14/ccgpr14/)>; see for different models of user participation, C. Waddams (2013), ‘*Customer Involvement: Frontier or Smokescreen*’, found at <<http://mir.epfl.ch/files/content/sites/mir/files/Newsletter/Vol%2016,%20No%201,%202014/Customer%20Involvement%20-%20Frontier%20or%20Smokescreen.pdf>>.

<sup>191</sup> See Ofwat (2011), ‘*Involving customers in price setting – Ofwat’s customer engagement policy statement*’, found at <[www.ofwat.gov.uk/future/monopolies/fpl/customer/pap\\_pos20110811custengage.pdf](http://www.ofwat.gov.uk/future/monopolies/fpl/customer/pap_pos20110811custengage.pdf)>, in which water companies have been obliged to foresee in user participation in the company’s business plans.

<sup>192</sup> Ibid, p. 3.

chairman<sup>193</sup> and stakeholders such as members from the Consumer Council for Water (CCWater), businesses, representation groups of citizens with specific needs and the Drinking Water Inspectorate.<sup>194</sup> All customer challenge groups are expected to submit a report to Ofwat alongside the business plan of their drinking water company. In this report, the customer challenge group indicates its view on the business plan of the drinking water company and it explains how the company made use of user participation.<sup>195</sup> Advantages mentioned by Ofwat which led to the implementation of user participation are the attainment of “a fair outcome to the price-setting process,”<sup>196</sup> greater customer focus of the drinking water companies and more incentives on the companies to innovate.<sup>197</sup>

Ofwat indicates that it will use the reports of the customer challenge groups in the review of the business plans of the drinking water companies.<sup>198</sup> Since drinking water companies are obliged to take into account user’s views, and the customer challenge groups hand over a report to Ofwat about their findings regarding representation of users’ views on the business plans, customer challenge groups are able to exercise considerable influence on the drinking water company.<sup>199</sup> In a review of the customer challenges groups performed by CCWater, CCWater found that customer challenge groups should also be used during future price reviews.<sup>200</sup>

From the organization of economic regulation in the UK, it can be seen that independence has advantages regarding the stability and predictability of regulation, whereas it also has a positive effect on investment in the sector.<sup>201</sup> User participation on the other hand, benefits economic regulation as users’ views can help improve

<sup>193</sup> Ofwat (2012), *Involving customers in price setting – Ofwat’s customer engagement policy: further information*, found at <[www.ofwat.gov.uk/future/monopolies/fpl/customer/prs\\_in1205customerengagement.pdf](http://www.ofwat.gov.uk/future/monopolies/fpl/customer/prs_in1205customerengagement.pdf)>, p. 2.

<sup>194</sup> See <[www.ofwat.gov.uk/pricereview/pr14/customer/prs\\_201305ccg](http://www.ofwat.gov.uk/pricereview/pr14/customer/prs_201305ccg)>.

<sup>195</sup> Ofwat (2013), *Setting price controls for 2015–20 – framework and approach – A consultation*, found at <[www.ofwat.gov.uk/pricereview/pr14/pap\\_con201301framework.pdf?download=Download](http://www.ofwat.gov.uk/pricereview/pr14/pap_con201301framework.pdf?download=Download)>, p. 35.

<sup>196</sup> Ofwat (2012), *Involving customers in price setting – Ofwat’s customer engagement policy: further information*, p. 1.

<sup>197</sup> Ofwat (2011), *Involving customers in price setting – Ofwat’s customer engagement policy statement*, p. 2.

<sup>198</sup> Ofwat (2013), *Setting price controls for 2015–20 – business planning expectations – a consultation*, found at <[www.ofwat.gov.uk/pricereview/pr14/pap\\_con201304busplanning.pdf?download=Download#](http://www.ofwat.gov.uk/pricereview/pr14/pap_con201304busplanning.pdf?download=Download#)>, p. 15.

<sup>199</sup> See for example Thames Water (2013), *Customer Challenge Group for Thames Water: Report to Ofwat on Thames Water Business Plan*, found at <[www.thameswater.co.uk/pr14/CCG-for-Thames-Water-report-to-Ofwat.pdf](http://www.thameswater.co.uk/pr14/CCG-for-Thames-Water-report-to-Ofwat.pdf)>, p. 7 where it is stated that Thames Water was willing to adapt its research strategy on the basis of requirements stemming from the customer challenge group.

<sup>200</sup> See CCWater (2014), *Customer Challenge Group process: Review of lessons learned*, found at <[www.cewater.org.uk/wp-content/uploads/2014/07/Customer-Challenge-Group-process-Review-of-lessons-learned2.pdf](http://www.cewater.org.uk/wp-content/uploads/2014/07/Customer-Challenge-Group-process-Review-of-lessons-learned2.pdf)>.

<sup>201</sup> Department for Environment, Food and Rural Affairs (2011), *Review of Ofwat and consumer representation in the water sector*, p. 3.

regulation. User participation also creates more support for regulatory actions as users may have a better understanding of what they pay for.

## 7.2. DUTCH ENERGY SECTOR

As required by EU law,<sup>202</sup> the ACM acts as independent regulator of the energy sector. The degree of independence of the ACM does not imply complete autonomy from government policy.<sup>203</sup> Instead, it implies that the independent regulator is able to implement regulations and policies without intervention of the executive.<sup>204</sup> In practice, this means that the ACM is independent from market parties and enjoys political independence. In order to supervise compliance with national and European energy laws, the competences of the ACM range from ex ante tariff regulation to ex post intervention by penalizing market parties for infringements of the Energy Act 1998.<sup>205</sup>

This independence of the ACM as regulator of the energy sector is coupled with a role for public participation. Public participation is regulated in the Electricity Act 1998, according to which representative organizations should be consulted by the ACM in preparation of method decisions regarding the calculation of several elements of the tariff for services provided by the system operators and according to which the joint system operators ought to consult with the representative organizations.<sup>206</sup> The consultation between the network operators and the network users takes place in the ‘User platform electricity- and gas system consultation’ and concerns for example conditions to gain access to the networks and the network tariffs. Through the involvement of representative organizations in regulatory decision-making, support is aimed to be created for the regulatory decisions taken by the ACM.<sup>207</sup> Despite that the exact involvement of representative organizations displays some weaknesses in practice,<sup>208</sup> the signal is given that stakeholders’ involvement in the regulatory decision-making process is valuable. It may create bigger support for the decisions of the ACM and may also prevent the stakeholders from appealing the decision at the administrative court.

<sup>202</sup> Article 35(4) Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC.

<sup>203</sup> See S. Lavrijssen and A. Ottow (2012), ‘Independent Supervisory Authorities: A Fragile Concept’, *Legal Issues of Economic Integration*, vol. 39 number 4, p. 428.

<sup>204</sup> Ibid.

<sup>205</sup> See for example Articles 41 and 77h Electricity Act 1998.

<sup>206</sup> Articles 33 and 41 Electricity Act 1998.

<sup>207</sup> ACM (2012), ‘*Evaluatie Elektriciteitswet 1998 en Gaswet – Eindverslag*’, found at <<https://www.acm.nl/nl/publicaties/publicatie/7176/Evaluatie-Elektriciteitswet-1998-en-Gaswet-door-de-NMa/>>, p. 44.

<sup>208</sup> See in that regard S. Lavrijssen, J. Eijkens and M. Rijkers, ‘The role of the highest administrative court and the protection of the interests of the energy consumers in the Netherlands’, *TILEC Discussion Paper*, p. 28.

Thus, economic regulation of the Dutch energy sector benefits from a large degree of independence combined with public participation. Both independence and public participation are guaranteed by law.

## 8. CONCLUSIONS AND RECOMMENDATIONS

### 8.1. CONCLUSIONS

The assessment of economic regulation of the drinking water sector shows that the current organization of economic regulation is inadequate in light of the principles of good regulation. The principles of independence, accountability, transparency, participation, effective legal protection and effectiveness are not fully complied with.

The current organization of economic regulation of the drinking water sector neither implements independence from market parties, nor political independence. Due to the role of the shareholders and Vewin in economic regulation, economic regulation of the drinking water sector cannot be independent from market parties. As evidenced by the findings of the OECD, shareholders of the drinking water companies do not have sufficient expertise to assess whether and which investments are necessary in the drinking water sector. This leads to risks of both under- and overinvestment. Where underinvestment could result in drinking water of an inferior quality, overinvestment could result in too high tariffs as drinking water might reach a quality which is ‘unnecessarily’ high.<sup>209</sup> From the viewpoint of the user of drinking water, both scenarios are undesirable.

In addition, economic regulation by the Minister of I&E and the inspectorate demonstrate that there is insufficient political independence. As a consequence, the risk exists that short-term political interests affect the economic regulation of the drinking water sector.

Economic regulation of the drinking water sector is not in line with the principle of transparency. On crucial points like the composition of the tariffs and the performance comparison, a lack of transparency comes forward. The principle of accountability is neither sufficiently reflected in economic regulation. The amount of players involved in the drinking water sector and the lack of transparency make it impossible for the Minister of I&E, the Inspectorate and the drinking water companies to render account to stakeholders in a transparent and meaningful way.

Furthermore, economic regulation of the drinking water sector provides insufficient possibilities for participation of stakeholders in economic regulation. Since there are no formal possibilities for participation of stakeholders, economic

<sup>209</sup> This latter argument is taken from P. Larouche, who indicated that inadequate economic regulation could have as consequence that users of drinking water pay an excessive tariff for drinking water because investments are made to increase the quality of drinking water to a level substantially higher than is needed for human consumption.

regulation hardly benefits from input from drinking water users, lobby groups, experts and other stakeholders.

Due to the lack of direct administrative appeal against important components of the drinking water tariff and the drinking water tariffs themselves, guarantees flowing from the principle of effective legal protection are at stake. Users of drinking water have little chances to receive effective legal protection from an independent administrative court against acts of the Minister of I&E, the Inspectorate, the ACM and the drinking water companies.

As the Minister of I&E, the Inspectorate, the shareholders of the drinking water companies and Vewin are no experts in economic regulation and they cannot guarantee compliance with the principles of good regulation, they are not well suited to act as economic regulator of the drinking water sector. As a consequence, protection of the rights of the users of drinking water is jeopardized.

In the following sub-paragraph, recommendations are made to improve economic regulation of the drinking water sector.

## 8.2. RECOMMENDATIONS

### 8.2.1. *To improve economic regulation of the drinking water sector, an independent and effective regulatory authority is needed*

It has been demonstrated that the transfer of economic regulation of the water sector to a politically independent regulator has clear advantages compared to the current situation. Considering that an independent regulator is more flexible than a purely legislative revision of the drinking water sector or other regulatory arrangements like regulation by contract, in the sense that an independent regulator can respond to developments in the market relatively fast and easily, the drinking water sector is expected to obtain the greatest benefits from an independent regulator. Political independence of the regulator has a positive effect on attracting investments and fosters innovation, as it increases the likelihood of consistent economic regulation adapted to the needs of the market.

### 8.2.2. *It is desirable to designate the ACM as independent economic regulator of the drinking water sector as it is well equipped for the task*

Because the ACM has specific expertise to undertake complex assessments which involve legal, technical and economic matters, it is well equipped to act as economic regulator of the drinking water sector. It would not be obvious to create a separate regulator for the water sector in the Netherlands, as the Dutch legislator has recently decided to merge different authorities within the ACM, making it responsible for the enforcement of competition law and consumer law as well for the regulation of the network industries. This means the ACM is already in charge of regulating, *inter alia*,

the energy and telecommunication sectors. As a consequence, the ACM has valuable experience in regulating network sectors. This may enable the authority to benefit from expertise, skills and knowledge that it has generated when regulating other sectors which might create several synergies when it will also be charged with the regulation of the water sector. In the process of tariff setting, carrying out the benchmark and overseeing compliance with the Drinking Water Act, Decision and Regulation, this expertise is indispensable. A further advantage of having the ACM as multi-sector regulator is that its reputation is already well-established, which increases its credibility towards regulated parties and consumers.

Since the drinking water companies do not actually compete, the ACM – as a regulator independent from market parties – is in the right position to monitor whether the drinking water companies do not abuse their dominant position but behave as if they operate in a competitive market by charging fair prices.

*8.2.3. As economic regulator of the drinking water sector, the ACM must adhere to the principles of good regulation*

Compliance with the principles of good regulation guarantees better protection of the users of drinking water against the monopolies of the drinking water companies. In order to attain a high quality of economic regulation, adherence to the principles of good regulation by the ACM is essential. Like in the UK and the Dutch energy sector, the ACM must take account of stakeholder input – in particular of input from the users of drinking water. Designating the ACM as economic regulator of the drinking water sector, should for example contribute to the transparency of economic regulation. The open practice of the ACM ensures that users of drinking water and other stakeholders have the possibility to check whether the ACM acts correctly. At the same time, users of drinking water also benefit from transparency on the side of drinking water companies, as the ACM has the task to ensure that transparency requirements are properly complied with by the drinking water companies. In this way, users of drinking water have insight in what they are paying for and whether they are receiving ‘value for money’ from their drinking water company.